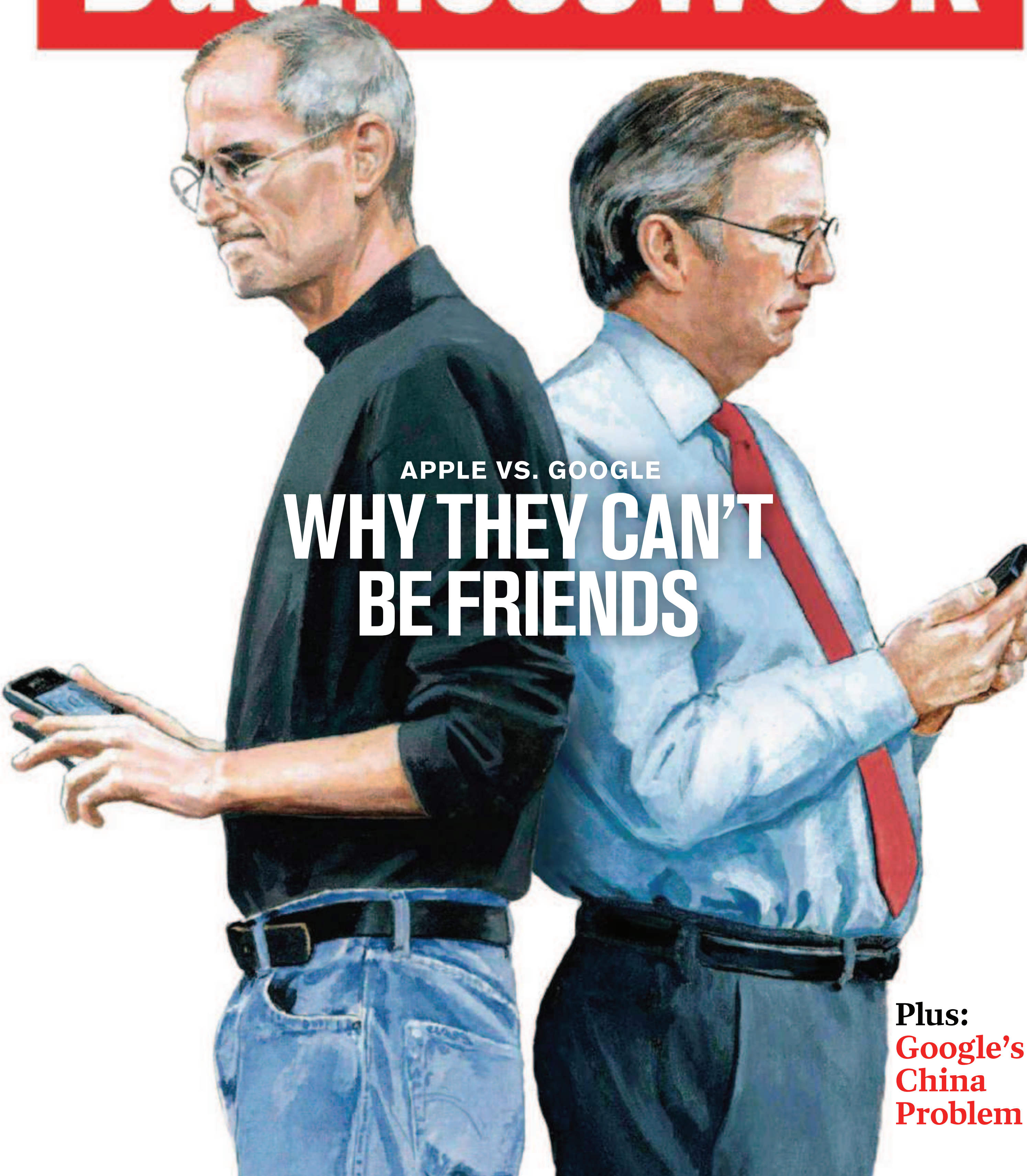
JANUARY 25, 2010 | BUSINESSWEEK.COM

KRAFT'S CHOCOHOLIC CEO | THE HUNT FOR AN AUTISM DRUG

Bloomberg BusinessWeek



APPLE VS. GOOGLE

WHY THEY CAN'T BE FRIENDS

Plus: Google's China Problem



WITHOUT INVESTORS THERE WOULD BE NO INDUSTRY, NO ECONOMY, NO JOBS, NO GROWTH.

INVESTORS ARE THE ONES WHO EARN THE MONEY. THEY'RE THE ONES WHO TAKE THE RISKS.

IT'S TIME INVESTORS GOT A BETTER DEAL.

AT SCHWAB, WE BELIEVE INVESTORS SHOULD GET THE HELP THEY NEED, WHEN THEY NEED IT.

AND WE BELIEVE IN PRICING THAT LEAVES INVESTORS WITH SOMETHING TO ACTUALLY INVEST.

BECAUSE AT SCHWAB, WE NEVER FORGET WHOSE MONEY IT IS.

READY TO RULE? VISIT YOUR LOCAL BRANCH, CALL 1-800-4SCHWAB OR GO TO SCHWAB.COM

©2010 Charles Schwab & Co., Inc. All rights reserved. Member SIPC. (0110-12208) ADP53478

www.storemags.com & www.fantamag.com

TALK TO CHUCK®

charles SCHWAB

www.storemags.com & www.fantamag.com



*EPA-estimated 23 city/34 hwy/27 combined mpg, Fusion S, I-4 automatic. Midsize class per R. L. Polk & Co. Non-hybrid.

www.storemags.com & www.fantamag.com



www.storemags.com & www.fantamag.com



THIS SOFA DESIGN COORDINATES WITH EVERYTHING. EVEN NATURE.







The true comfort of this furniture comes from knowing what's inside it: a new kind of foam created in part from renewable resources. Manufacturers of foam for the furniture and bedding industries wanted to use less petroleum-based ingredients in their products and asked Cargill for help. Using soybean oil and chemistry, we developed BiOH™ polyols, a new foam-making ingredient. The resulting product performs like traditional foam, yet consumes less petroleum. Several national brands are now using it in their furniture—making homes more inviting for both people and nature. This is how Cargill works with customers.

collaborate > create > succeed™

www.cargill.com/creates

©2009 Cargill, Incorporated

food, agriculture & risk management solutions

Cargill®

www.storemags.com & www.fantamag.com

Bloomberg BusinessWeek In Depth



Volkswagen unveils its New Concept Coupe at the Detroit auto show

28 | **Apple Vs. Google**

From smartphones to computing to advertising, Silicon Valley's former allies are increasingly at war. Why the future of technology rides on the outcome of their many clashes to come

36 | **Kraft's Sugar Rush**

Kraft CEO Irene Rosenfeld's determination to acquire Cadbury, the British candymaker, frayed her relationship with shareholder Warren Buffett and will define her career, no matter how it all shakes out

40 | **Pills for Autism?**

Armed with fresh medical insights, drug companies are redoubling their efforts to tackle the complex causes of the condition. With a growing population of autistic adults in need of care, the stakes are high

44 | **The Car Giant To Watch**

Volkswagen's aim to become the world's biggest carmaker would have seemed far-fetched not long ago. Now, with Toyota in a funk and VW on a roll, it's time to take that possibility seriously

(COVER) ILLUSTRATION BY JOSIE JAMMET, BASED ON PHOTOGRAPHS BY PAUL SAKUMA/AP PHOTO (STEVE JOBS), ANDREW HARRER/BLOOMBERG (ERIC SCHMIDT); (THIS PAGE) JEFF KOWALSKY/BLOOMBERG

www.storemags.com & www.fantamag.com

BusinessWeek The Global Report


JPMorgan Chase CEO Dimon in D.C.

The Week in Business

08 | Executive Summary Conan says "No!" to NBC; Heineken goes to Mexico; China's export surge

14 | Business Outlook The global post-stimulus debt hangover

15 | Numbers Where the bears are placing their bets

16 | At the Table Charlie Rose talks to Mideast envoy George Mitchell

New Business

18 | The Missing Witness Who the Financial Crisis Inquiry Commission really needs to hear from

20 | Empty Clawbacks? This year many executives will have conditions tied to their bonuses

21 | Intel Under Assault Qualcomm chips edge closer in the gadget war

22 | Tablet Time They're hyped, and have been before. Are consumers finally ready for tablet PCs?

23 | Easing Pain in Ukraine An election offers hope for growth

24 | Crying for Argentina A divisive battle over government debt

25 | Chávez Logic Why Venezuela's devaluation makes some sense

26 | Default in Dubai Its first housing foreclosure, with more to follow

What's Next

50 | Healthy Pepsi The snack and soda company's earnest push to make its offerings more nutritious

52 | Amgen's Hope Its osteoporosis drug, awaiting approval, may also be an anti-cancer blockbuster

53 | IBM's Patents By volume, it's the patent king. So why is its portfolio worth a third of Microsoft's?

54 | The Quiznos Comeback Beaten down by Subway, the chain has discovered the power of value

55 | Acquisitive Yahoo! CEO Bartz has a shopping spree planned

56 | Indebted Europe The Continent's problem gets worse

57 | EPA Crackdown The U.S. agency isn't waiting for new laws to go after corporate polluters

59 | Unforgiven Hedge Funds Investors take their revenge

Personal Business

61 | Money Report Upbeat forecasts for the Aussie and Canuck bucks; an earnings pop; a platinum ETF

62 | How To Play It Are Apple and Google still smart bets?

63 | Investing Getting over your jaundiced view of bank stocks

64 | Investing Why you should look for a fund manager with skin in the game


Pepsi CEO Nooyi's good-for-you agenda


Nobel winner Stiglitz on Obama

Business Views

66 | Books Stiglitz: *Freefall*

68 | Tech & You Rich Jaroslovsky says the Nexus One is a good smartphone, but no game-changer

69 | Feedback Permanent temps

72 | Outside Shot Innovation's accidental enemies: CEOs

69 | Corrections & Clarifications

70 | Company Index

(TOP TO BOTTOM) JAY MALLIN/BLOOMBERG; DAVID JOHNSON/CORBIS; OLIVIER ROLLER/FEDEPHOTO/PIXPALACE

www.storemags.com & www.fantamag.com

When you love what you do...it shows!



Clients tell us that Grant Thornton really stands out. They say it's because our people have a passion for delivering professional, personalized service. A recent client satisfaction survey of audit and tax clients conducted by an independent research firm funded by Grant Thornton LLP, tells the tale (see chart, right).

To find out more, access the results at **GrantThornton.com/clientsatisfaction** or give our CEO **Stephen Chipman** a call at **312.602.8003**. When it comes to delivering professional, personalized service and value for fees, our people have a passion for exceeding clients' expectations.

Why not find out what it's like to work with people who love what they do?

0 - 10 scale	Grant Thornton LLP	Big Four	Other firms mentioned	Statistically significant?
Audit	8.56	lower	lower	yes
Tax	8.69	lower	lower	yes
Value for fees (tax/audit)	8.47/8.11	lower	lower	yes

Grant Thornton

Audit • Tax • Advisory

Grant Thornton refers to Grant Thornton LLP, the U.S. member firm of Grant Thornton International Ltd, an organization of independently owned and managed accounting and consulting firms.

www.storemags.com & www.fantamag.com

Edited by Harry Maurer and Cristina Lindblad

THE WEEK IN BUSINESS


Leno's show didn't work at 10


Zucker had an easy fix: Move Leno


O'Brien refused to go along

STRATEGY

CONAN THE CONTRARIAN

It was a great plan while it lasted. **NBC's** attempt to save face after affiliates rejected five nights of ***The Jay Leno Show*** at 10p.m., was upended when ***Tonight Show*** host **Conan O'Brien** refused to move his show to 12:05 to make room for Leno at 11:35. Saying he "honestly believes" the move would be the show's "destruction," Conan at press time was locked in talks with NBC, headed by **Jeff Zucker,** to extricate himself from his three-year contract. O'Brien hired heavyweight Hollywood litigator **Patricia Glaser** to win what his side contends is as much as $50 million owed him because NBC violated contract terms. The network has countered, insiders say, that changing the show's time slot doesn't violate the agreement. Meanwhile, NBC is scrambling to fill the 10 p.m. hour with dramas, ***Dateline,*** and other shows, while **Fox** has said that if Conan is a free agent, it would like to talk with him. Various media outlets, citing Leno camp insiders, reported that he might bolt NBC as well.

▸ "Mr. Zucker, Comcast on Line Three"
businessweek.com/magazine

HEINEKEN SCORES IN MEXICO

The beer business just keeps getting more global, as brewers ignore borders to quaff rivals. The latest deal: Heineken's Jan. 11 purchase of Mexico's second-largest beer producer. The Dutch brewer will pay $5.2 billion, all in stock—and absorb $2.1 billion in debt—for the beer unit of **Femsa.** That gives Heineken valuable brands (**Dos Equis, Tecate, Sol**) and a strong foothold in developing Latin American countries where beer consumption is growing faster than in Heineken's traditional European market. Next likely deal : **Grupo Modelo,** Mexico's biggest brewer, may get swallowed up by **Anheuser-Busch InBev,** which already owns just over 50% of the maker of No. 1 brand **Corona.**

-4.8%

2009 contraction in British GDP, the biggest one-year decline since 1921

Data: National Institute of Economic and Social Research

ECONOMICS & POLICY

DISASTER IN HAITI

The worst earthquake to hit the Caribbean region in 200 years struck Haiti on Jan. 12. **Prime Minister Jean-Max Bellerive** said "well over" 100,000 people may have died, though his estimate was just that. The quake destroyed much of the capital, Port-au-Prince, inflicting even greater economic pain on the hemisphere's poorest nation. The magnitude 7.0 temblor rated 9 on a 1-to-10 scale that measures the shaking of the ground. That contributed to extensive damage to Haiti's many makeshift dwellings, though larger buildings, including the presidential palace, also collapsed.

THE CHINESE DYNAMO

China passed two milestones this week, offering more evidence of how handily it has weathered the financial crisis—and causing more irritation among its trading partners.

(L-R) JUSTIN LUBIN/NBCU PHOTO BANK/AP PHOTO; JUSTIN STEELE/*THE NEW YORK TIMES*/REDUX; KEVIN WINTER/GETTY IMAGES

www.storemags.com & www.fantamag.com

EXECUTIVE SUMMARY

Exports in December jumped 17.7% from November, their first increase in 14 months. For the year, China exported $1.2 trillion worth of goods, surpassing Germany, with an estimated $1.17 trillion, as the world's top exporter. That seemed certain to intensify pressure on Beijing to let the yuan rise rather than keeping it pegged to the sinking dollar. China also announced, on Jan. 11, that it has become the largest auto market in the world, as sales climbed 46% in 2009, to 13.6 million (including heavy commercial vehicles.) That far exceeded the traditional leader, the U.S., with 10.9 million sales. China is expected to remain atop the market for 2010.


KEVIN LEE/BLOOMBERG

Containers at the port of Shanghai: China is now the world's No. 1 exporter

OBAMA TAPS THE BANKS

The Obama Administration has stepped up its effort to recoup as much as possible of the $700 billion in TARP money used to bail out financial institutions and auto companies. **President Obama** was scheduled to announce on Jan. 14 a new fee on the biggest banks that would make the government whole on its losses, which could run as high as $120 billion. The fee, which *The Wall Street Journal* reported would consist of a tax on banks' liabilities, will probably stay in effect for some years, but Obama is expected to include revenue from the fees in his proposed budget for 2011. Banks responded with outrage and claimed they would harm the economy. "To impose yet another burden on the industry would obviously decrease [its] ability to lend," warned **Edward Yingling,** president of the **American Bankers Assn.**

HEARINGS ON THE CRISIS

On Jan. 13 the **Financial Crisis Inquiry Commission** held its first hearing, with four Wall Street bosses on the hot seat: **Lloyd Blankfein** of **Goldman Sachs, Jamie Dimon** of **JPMorgan Chase, John Mack** of **Morgan Stanley,** and **Brian Moynihan** of **Bank of America.** Each conceded that financial service firms took excessive risks, but implied that all the really horrific stuff happened in some other guy's shop. "Too many financial institutions and investors simply outsourced their risk management," said **Blankfein** in his opening statement. Chaired by **Phil Angelides,** a former state treasurer of California, the commission is



EXECUTIVE SUMMARY



Florida's farmers watered orange trees through the night to protect them from cold

slated to conduct a months-long investigation into the meltdown and make proposals for reform in a report due in December. But whatever light Angelides manages to throw on the matter probably won't bring major change, because investment bankers have already fended off legislative proposals for aggressive regulatory reform.

| BW | PAGE 18 "The Crisis Commission's Missing Witness"

FLORIDA'S FREEZE

It's not yet clear how hard Florida farmers were hit by the worst cold snap in 21 years, but losses will be serious, local growers and state officials say. Florida oranges, grapefruit, strawberries, sugar cane, and other crops harvested over the winter months make up a $20 billion slice of the state's $128 billion agricultural output. **Dan Kottlowski,** a senior meteorologist at **AccuWeather.com,** says his firm estimates that 5% of the orange crop suffered some impact. A frost warning was issued well ahead of time, and farmers took precautions ranging from picking strawberries early to watering fruit trees all night to help them avoid the worst effects of a sharp frost. But "there's only so much you can do when Mother Nature unfurls her fury," says **Terence McElroy,** a spokesman for the **Florida Agriculture Dept.** McElroy predicts the damage could run as high as hundreds of millions of dollars.

TECHNOLOGY

GOOGLE DECLARES WAR

The search king is losing patience with Beijing's Internet policy. On Jan. 12, Google said it will stop censoring search results on its Chinese site, **Google.cn,** in response to what the company called a "highly sophisticated" hacking of its Web site from China and the infiltration of **Gmail** accounts of human-rights activists in China and elsewhere. "Over the next few weeks we will be discussing with the Chinese government the basis on which we could operate an unfiltered search engine within the law, if at all," wrote Google's chief legal officer, **David Drummond,** on the company's official blog. Since Beijing is unlikely to back down, Google may well pull the plug on its Chinese operations. That might offer a graceful way out of a troubled business: The overwhelming search favorite in the U.S. has never dominated in China, running second with about 36% of the market to **Baidu's** 58%.

| BW | PAGE 35 "Google and China: A Win for Liberty—and Strategy

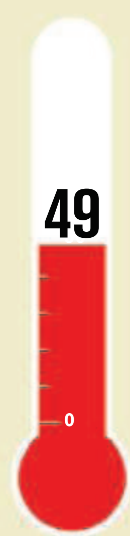
LEADERSHIP

MICKEY D'S NEW CHEF

McDonald's has a new heir apparent, Don Thompson



Since taking over **McDonald's** in 2004, **Chief Executive James Skinner** has hired—and lost—two chief operating officers and heirs apparent. On Jan. 11 the 65-year-old Skinner named his third, elevating another veteran of the world's top restaurant chain to president and COO. **Don Thompson,** 46, succeeds **Ralph Alvarez,** who resigned in December, citing health reasons. Thompson joined the Golden Arches in 1990 as an electrical engineer and has run McDonald's USA—the company's biggest division—since 2006. He beat out two other insiders: **Denis Hennequin,** who runs McDonald's in Europe, and



THE OPTIMISM METER

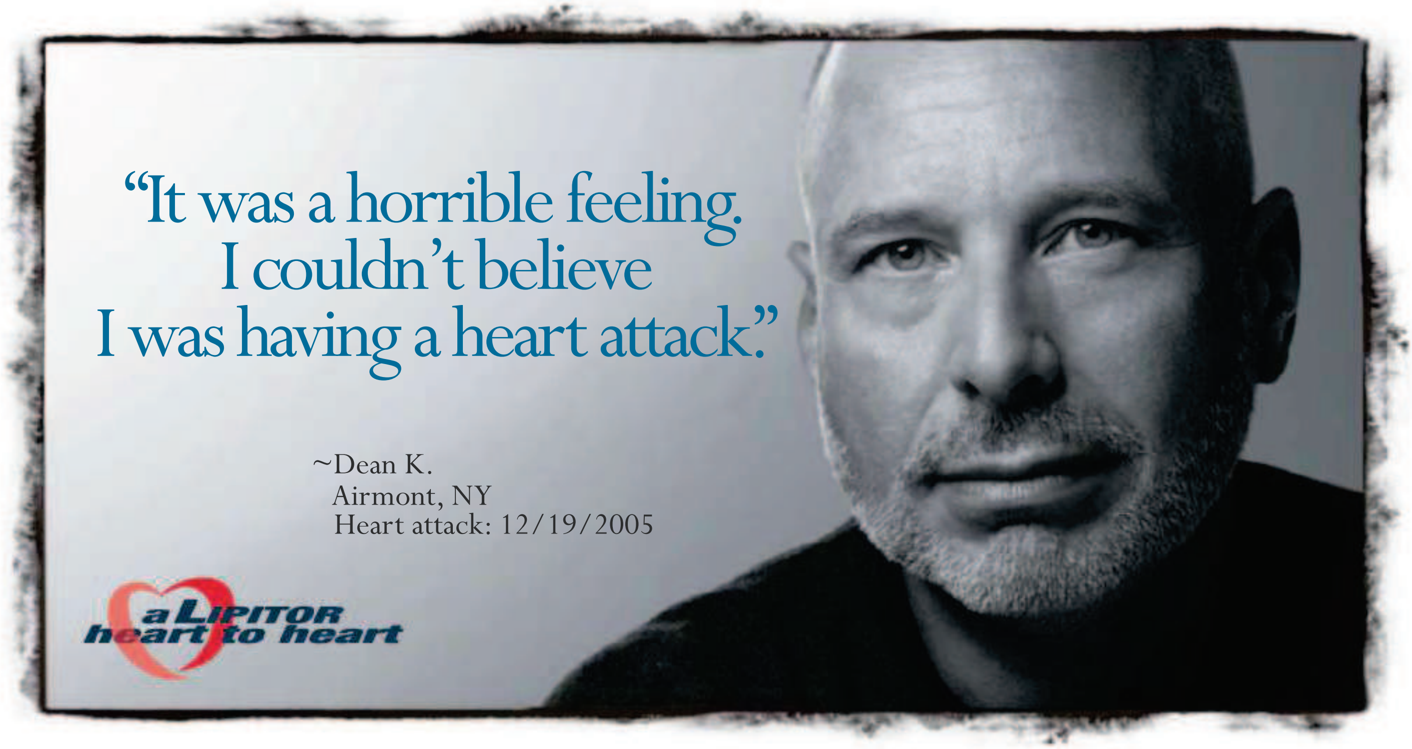
DISCOURAGING SIGNALS

The Meter clocked in at 49 on Jan. 12, down from 52 a week earlier, as attitudes became decidedly less cheery. The share of individuals who think that equity markets and home prices will rise in 2010 dropped over the past week, and more believe that the unemployed will continue to struggle to find new jobs. Developed by ***Bloomberg BusinessWeek*** using data from pollster **YouGov**, the Meter is a proprietary measure of sentiment and expectations, economic statistics, and market forecasts.

0=lowest and 100=highest

(TOP) SCOTT AUDETTE/POLARIS

www.storemags.com & www.fantamag.com



"I should've done more to take care of myself. Now I'm exercising, watching my diet, and I trust my heart to Lipitor." Talk to your doctor about your risk and about Lipitor.

- **Adding Lipitor may help, when diet and exercise are not enough. Unlike some other cholesterol-lowering medications, Lipitor is FDA-approved to reduce the risk of heart attack and stroke in patients with several common risk factors, including family history of early heart disease, high blood pressure, low good cholesterol, age and smoking.**
- **Lipitor has been extensively studied with over 17 years of research. And Lipitor is backed by 400 ongoing or completed clinical studies.**

IMPORTANT SAFETY INFORMATION:
LIPITOR is not for everyone. It is not for those with liver problems. And it is not for women who are nursing, pregnant or may become pregnant.

If you take LIPITOR, tell your doctor if you feel any new muscle pain or weakness. This could be a sign of rare but serious muscle side effects. Tell your doctor about all medications you take. This may help avoid serious drug interactions. Your doctor should do blood tests to check your liver function before and during treatment and may adjust your dose.

Common side effects are diarrhea, upset stomach, muscle and joint pain, and changes in some blood tests.

INDICATION:
LIPITOR is a prescription medicine that is used along with a low-fat diet. It lowers the LDL ("bad" cholesterol) and triglycerides in your blood. It can raise your HDL ("good" cholesterol) as well. LIPITOR can lower the risk for heart attack, stroke, certain types of heart surgery, and chest pain in patients who have heart disease or risk factors for heart disease such as age, smoking, high blood pressure, low HDL, or family history of early heart disease.

LIPITOR can lower the risk for heart attack or stroke in patients with diabetes and risk factors such as diabetic eye or kidney problems, smoking, or high blood pressure.

Please see additional important information on next page.

LIPITOR
atorvastatin calcium
tablets

Have a heart to heart with your doctor about your risk. And about Lipitor.
Call 1-888-LIPITOR (1-888-547-4867) or visit www.lipitor.com/dean

You are encouraged to report negative side effects of prescription drugs to the FDA. Visit www.fda.gov/medwatch or call 1-800-FDA-1088.

© 2009 Pfizer Inc. All rights reserved. LPU01267IA

www.storemags.com & www.fantamag.com

IMPORTANT FACTS

LIPITOR atorvastatin calcium tablets (LIP-ih-tore)

LOWERING YOUR HIGH CHOLESTEROL

High cholesterol is more than just a number, it's a risk factor that should not be ignored. If your doctor said you have high cholesterol, you may be at an increased risk for heart attack and stroke. But the good news is, you can take steps to lower your cholesterol.

With the help of your doctor and a cholesterol-lowering medicine like LIPITOR, along with diet and exercise, you could be on your way to lowering your cholesterol.

Ready to start eating right and exercising more? Talk to your doctor and visit the American Heart Association at www.americanheart.org.

WHO IS LIPITOR FOR?

Who can take LIPITOR:

- People who cannot lower their cholesterol enough with diet and exercise
- Adults and children over 10

Who should NOT take LIPITOR:

- Women who are pregnant, may be pregnant, or may become pregnant. LIPITOR may harm your unborn baby. If you become pregnant, stop LIPITOR and call your doctor right away.
- Women who are breast-feeding. LIPITOR can pass into your breast milk and may harm your baby.
- People with liver problems
- People allergic to anything in LIPITOR

BEFORE YOU START LIPITOR

Tell your doctor:

- About all medications you take, including prescriptions, over-the-counter medications, vitamins, and herbal supplements
- If you have muscle aches or weakness
- If you drink more than 2 alcoholic drinks a day
- If you have diabetes or kidney problems
- If you have a thyroid problem

ABOUT LIPITOR

LIPITOR is a prescription medicine. Along with diet and exercise, it lowers "bad" cholesterol in your blood. It can also raise "good" cholesterol (HDL-C).

LIPITOR can lower the risk of heart attack, stroke, certain types of heart surgery, and chest pain in patients who have heart disease or risk factors for heart disease such as:

- age, smoking, high blood pressure, low HDL-C, family history of early heart disease

LIPITOR can lower the risk of heart attack or stroke in patients with diabetes and risk factors such as diabetic eye or kidney problems, smoking, or high blood pressure.

POSSIBLE SIDE EFFECTS OF LIPITOR

Serious side effects in a small number of people:

- **Muscle problems** that can lead to kidney problems, including kidney failure. Your chance for muscle problems is higher if you take certain other medicines with LIPITOR.
- **Liver problems**. Your doctor may do blood tests to check your liver before you start LIPITOR and while you are taking it.

Call your doctor right away if you have:

- Unexplained muscle weakness or pain, especially if you have a fever or feel very tired
- Allergic reactions including swelling of the face, lips, tongue, and/or throat that may cause difficulty in breathing or swallowing which may require treatment right away
- Nausea, vomiting, or stomach pain
- Brown or dark-colored urine
- Feeling more tired than usual
- Your skin and the whites of your eyes turn yellow
- Allergic skin reactions

Common side effects of LIPITOR are:

- Diarrhea
- Upset stomach
- Muscle and joint pain
- Changes in some blood tests

HOW TO TAKE LIPITOR

Do:

- Take LIPITOR as prescribed by your doctor.
- Try to eat heart-healthy foods while you take LIPITOR.
- Take LIPITOR at any time of day, with or without food.
- If you miss a dose, take it as soon as you remember. But if it has been more than 12 hours since your missed dose, wait. Take the next dose at your regular time.

Don't:

- Do not change or stop your dose before talking to your doctor.
- Do not start new medicines before talking to your doctor.
- Do not give your LIPITOR to other people. It may harm them even if your problems are the same.
- Do not break the tablet.

NEED MORE INFORMATION?

- Ask your doctor or health care provider.
- Talk to your pharmacist.
- Go to **www.lipitor.com** or call **1-888-LIPITOR**.

Uninsured? Need help paying for Pfizer medicines? Pfizer has programs that can help. Call **1-866-706-2400** or visit **www.PfizerHelpfulAnswers.com.**

Pfizer helpful answers®

Manufactured by Pfizer Ireland Pharmaceuticals, Dublin, Ireland
© 2009 Pfizer Ireland Pharmaceuticals All rights reserved.
Printed in the USA.

Distributed by Parke-Davis, Division of Pfizer Inc.
New York, NY 10017 USA
June 2009

Rx only

www.storemags.com & www.fantamag.com

EXECUTIVE SUMMARY

Timothy Fenton, the company's Asia-Pacific head.

MORE CHANGES AT CITI

Last year, when Washington became the largest shareholder in Citigroup, regulators ordered the bank to get a management appraisal from an outside consultant. That report has now sparked yet another shuffle of top executives. On Jan. 11, Citi said that **Manuel Medina-Mora,** who oversees units in Mexico and South America, will take over the North American consumer business from **Terri Dial,** who got poor marks in the report. Responsibilities also may change for other panned executives, including **Vice-Chairman Lewis Kaden** and **Chief Administrative Officer Don Callahan,** a person briefed on the matter said. **CEO Vikram Pandit,** who won a mostly positive review, stays in his post. Dial was the highest-ranking woman at Citi and was one of the first people Pandit hired when he took over in late 2007.

FINANCE

DO-GOODERS AT GOLDMAN?

Preparing for the negative publicity that's certain to fall on Wall Street when the first 2009 bonus checks are cut, **Goldman Sachs** is pondering the expansion of a program requiring top staff to donate a percentage of their earnings to charity. *The New York Times* reported on Jan. 11 that the firm may adopt a scheme like one at failed investment bank **Bear Stearns,** which compelled more than 1,000 employees to donate 4% of their pay each year. Were Goldman to impose something similar, hundreds of millions of dollars would flow into philanthropic causes. Goldman already has a program under which its 400-plus partners must donate an undisclosed amount to charity. It also set up, in October, a $500 million fund for loans to small business, to be partly overseen by one of its biggest shareholders, **Warren Buffett.**

BW | PAGE 20 "Empty Clawbacks?"



Buffett will help oversee a $500 million Goldman fund for small businesses

IDEAS ALL WORKED UP OVER PRIVACY ON THE WEB

Is privacy dead in the age of the Internet? **Facebook** founder **Mark Zuckerberg,** speaking at an awards ceremony in San Francisco this month, said as much, when he commented that privacy is "no longer a social norm." His words kicked off a lively debate in the blogosphere.

Marshall Kirkpatrick, on the technology industry blog **ReadWriteWeb,** grants that, because of sites like Facebook, the notion of privacy can no longer be equated with absolute secrecy. A contemporary understanding of privacy centers on context, writes Kirkpatrick: "We expect our communication to go on in an appropriate context (no drinking in church or praying in the bar) and we expect to understand how our communication will be distributed." So if a college pal snapped photos of you carousing at a bar and showed them to people at church, you might feel your privacy has been violated—even though the bar is a public place. Kirkpatrick goes on to argue that just because some people think nothing of posting compromising pictures on their Facebook page, Zuckerberg should not assume the rest of the site's 350 million will readily give up the right to control who can view such material. (Facebook last year rejiggered its privacy settings, making "public" the default setting for text, photo, and video updates.)

On his blog **Net.Effect, Evgeny Morozov** notes that, Zuckerberg's pronouncements aside, some governments are moving toward reinforcing privacy protections. In France, for instance, a bill under debate would give Internet users the option of having old online data about themselves deleted—though the technology to make this possible is not yet available.



Zuckerberg said that privacy is "no longer a social norm"

"Why Facebook Is Wrong: Privacy Is Still Important" ReadWriteWeb, Jan. 11
"France Wants to Forget; Facebook Doesn't" Net Effect, Jan. 10

(FROM TOP) ANDREW HARRER/BLOOMBERG; MATTHEW STAVER/BLOOMBERG

www.stopmags.com & www.fantamag.com

BUSINESS OUTLOOK | WILLIAM PESEK

AFTER THE STIMULUS BINGE, A DEBT HANGOVER

Trillions of dollars have been spent keeping the global economy afloat. But now fears about the Great Recession are giving way to worries about something else: The Great Reckoning.

Government policymakers from Washington to Tokyo are tallying the bill for last year's stimulus binge, and the results won't be pretty for investors or elected officials. Since the collapse of Lehman Brothers in September 2008, the Group of 20 largest industrialized economies have spent more than $2.2 trillion—much of it borrowed—trying to restore growth.

This unprecedented public debt glut will complicate the global recovery. That's because the government debt entering the bond markets will make it harder for private companies to issue debt of their own, either to expand or simply ride out the lingering effects of the credit crisis.

This so-called crowding-out dynamic, together with rising borrowing costs, will depress job growth. The more that small- and medium-sized businesses are starved for credit, for example, the fewer new employees they will add. The crowding also could lift interest rates for consumers.

That's the downside of a stimulus binge: It pumps up growth initially, but the hangover can be painful across an economy for years to come.

118%

The level public debt, as a percent of GDP, will reach in advanced G-20 economies by 2014

Data: International Monetary Fund

Even assuming some budget trimming, the International Monetary Fund expects government debt in advanced G-20 economies to reach 118% of their combined gross domestic product by 2014, up from 78.2% in 2007, just before the economic crisis took hold. Getting to a more sustainable 60% level will involve raising taxes and cutting services.

President Barack Obama's dilemma is not unique: Raising taxes to reduce debt may delay a solid recovery, while trimming spending too much could erode the social safety net and damage competitiveness in the long run. Either way, he and other heads of state struggling with mounting debt burdens are likely to find economic growth over the next decade slower than in the last.

Japan is a poster child for the Great Reckoning. Asia's biggest economy has little to show for the 30 trillion yen ($329 billion) that the government has pumped into it since late 2008. Unemployment, already at a near-record 5.2%, is edging higher. Meanwhile, deflation is intensifying, wages are stagnant, and worried households are saving more and spending less. Worse, Japan's population is aging rapidly, reducing the tax base and raising social costs.

The most indebted among industrialized nations, with public debt approaching 200% of GDP, slow-growth Japan risks seeing a downgrade of its Aa2 credit rating this year. "Japan is the mega-risk problem. It's the next big thing that will hit credit markets," says Carl Weinberg, chief economist at High Frequency Economics.

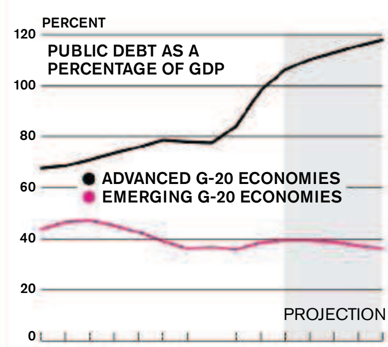
Expect both credit-rating agencies and investors in 2010 to be sniffing around for other potential debt troubles, be they in China, Greece, Mexico, Vietnam, or even the U.S. Any move to downgrade credit ratings could shake global markets, boosting mortgage rates around the globe and hurting stock prices.

The unwinding process will keep central bankers like Federal Reserve Chairman Ben Bernanke busy as well. The Bank of Japan and the Fed are holding interest rates near zero, while the Bank of England and European Central Bank aren't far behind. All that liquidity is finding its way into stock and real estate markets from Mumbai to Shanghai to São Paulo, creating fresh bubbles and increasing the risk of inflation.

But the debt burden makes it harder to move rates back to more normal levels, since boosting borrowing costs will increase that even more.

Other nations will be set back in underappreciated ways. What economies like India, Indonesia and the Philippines have in common are young populations. Unless you create opportunities and well-paid jobs for them, these societies risk becoming breeding grounds for greater poverty and violence, the most unwelcome part of the Great Reckoning. | BW |

GOVERNMENT DEBT IN RICH NATIONS IS SOARING



Data: International Monetary Fund

www.storemags.com & www.fantamag.com

NUMBERS

WHERE THE BEARS ARE PLACING THEIR BETS

By Tara Kalwarski/Charts by David Foster

The U.S. stock market's short-interest ratio—a measure of how many investors are betting on a fall—has increased by almost 50% since March. The ratio is calculated by taking the number of shares borrowed and sold short and dividing it by the average daily trading volume.

Low Expectations: These companies are among the most heavily shorted in the S&P 500.

MOST SHORTED S&P 500 COMPANIES	SHORT-INTEREST RATIOS* DEC. '08	2009 CHANGE IN STOCK PRICE	SHORT-INTEREST RATIOS* DEC. '09
McCORMICK & CO.	3.0	13%	19.3
WASTE MANAGEMENT	7.2	2%	18.1
FASTENAL	7.5	19%	16.8
M&T BANK	8.6	17%	15.7
VULCAN MATERIALS	9.0	−24%	15.6
MYLAN	10.4	86%	14.9
TOTAL SYSTEM SERVICES	2.3	23%	11.7
NEWELL RUBBERMAID	1.3	53%	11.6
FEDERATED INVESTORS	1.4	62%	11.6
IRON MOUNTAIN	10.5	−8%	11.3

Data: Bloomberg

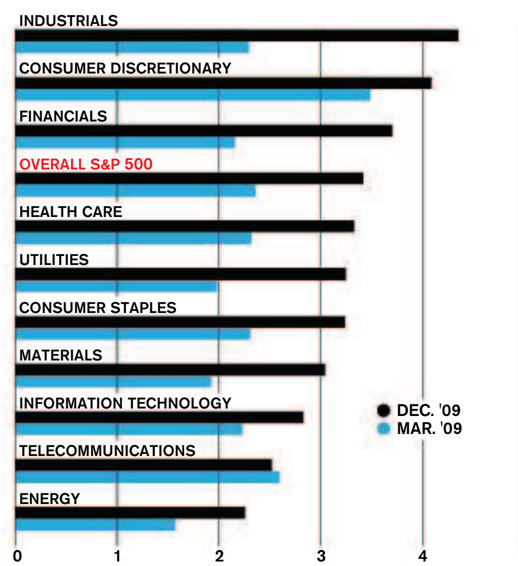
*As of Dec. 31

1.3 Number of S&P 500 short contracts bought on the Chicago Mercantile Exchange last month for each long contract, the highest ratio since at least 1993

Data: Bloomberg, Commitments of Traders Report

Shorted Sectors: Industrial companies have drawn the most attention from short-sellers.

SHORT-INTEREST RATIO BY S&P 500 SECTOR*

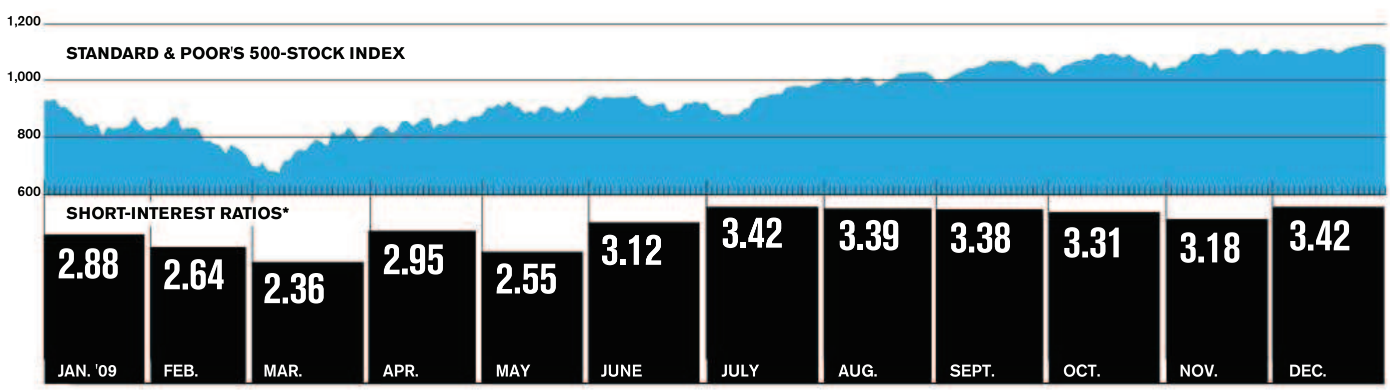


*Number of shares borrowed and sold short, divided by average daily trading volume

Data: Bloomberg

THE SHORT AND THE LONG OF IT

The S&P 500's short-interest ratio was at a low just as the market started to turn in March 2009.



Data: Bloomberg

*Figures are mid-month

www.storemags.com & www.fantamag.com

AT THE TABLE CHARLIE ROSE





GEORGE MITCHELL
His Dogged Drive for Mideast Peace

George Mitchell, the former Senate Majority Leader who is now President Barack Obama's Special Envoy to the Middle East, has a record of bringing intractable opponents together, dealing with delicate issues, and brokering sustainable agreements. Most famously, he chaired the peace talks in Northern Ireland that led to the historic Good Friday agreement of 1998. And in 2006 he headed a commission that examined allegations of steroid abuse by Major League Baseball players. He also served for several years as chairman of Walt Disney.

Mitchell has spent the past year trying to get Israelis and Palestinians back to the negotiating table after a stalemate that critics attribute to the Obama Administration's early focus on freezing new Israeli settlements. Mitchell was a guest on *The Charlie Rose Show* on Jan. 6. This is an edited version of those conversations.

CHARLIE ROSE

Do you have a hard time with the perception that the U.S. is not an innocent broker in the Mideast?

GEORGE MITCHELL

Oh, I hear it a lot here, in Europe, and in the Middle East, but I don't believe it. That assertion is based on the assumption that the U.S. cannot at the same time be totally committed to Israel's security, which we are, and be totally committed to the creation of the Palestinian state, which we are. To the contrary, I believe they are mutually reinforcing. It will help Israel get security for its people if the Palestinians have a state.

(FROM TOP) PHOTOGRAPHS BY BRAD TRENT; SAUL LOEB/AFP/GETTY IMAGES

www.storemags.com & www.fantamag.com

What's the mood over there about the possibilities in a new year?
I think there's more optimism there than here, but you have to temper it with reality —the complexity and length of the conflict. [One focus will be on] economic growth, helping the Palestinians improve their economy and encouraging the current Prime Minister—an impressive person, Salaam Fayyad—who is trying to build from the ground up the institutions that can govern effectively on Day One of the Palestinian state.

There is this impression, reflected in a *New York Times* editorial, that the past year has not been successful because the Administration stressed a settlement freeze.
A little over a year ago—before I knew President Obama and had any idea I would be asked to take this job—I was in Israel, and I gave a speech at a university. And I was asked a question about Northern Ireland. In my answer, I pointed out that the peace agreement in Northern Ireland came 800 years after the British domination began. After the speech, an elderly gentleman, hard of hearing, came up to me. He said in a loud voice: "Senator Mitchell, did you say 800 years?" I said: "Yes, 800 years." He said: "No wonder you settled, it's such a recent argument." To think that an issue that's gone on longer than 800 years is going to be resolved in a few months if we only take this step or that is really, I think, misperceiving the complexity and difficulty.

But the point was that by focusing on a settlement freeze—which Israelis were unlikely to agree to—you created disappointment from the beginning because it was unachievable.
All you have to do is go back and read the papers over the past five or six years to see that it was not the Obama Administration or the Secretary of State or me who suggested a settlement freeze. Every Arab country, including the Palestinians—and I visited 13 of them before we began substantive discussions with the Israelis—said that there would be no progress without a freeze. Secondly, you've been in a lot of negotiations. If you want to get 60%, do you begin by asking for 60%? So what we got was a moratorium—10 months, far less than what was requested but more significant than any action taken by any previous government of Israel for the 40 years that the settlement [movement] has existed.

"DESPITE THE HORRIFIC EVENTS OF THE PAST HALF CENTURY," A MAJORITY ON BOTH SIDES STILL BELIEVES IN PEACE

Why is a peace agreement possible?
Because it's in the best interest of the people on both sides.

It's been in their best interest for a long time.
Despite the horrific events of the past half century—all the death, destruction, mistrust, and hatred—a substantial majority on both sides still believes that's the way to resolve the problem.



Right-wing Jewish settlers earlier this month protest the freeze on settlements

DAVID SILVERMAN/GETTY IMAGES

Do you have a time frame? Two years?
We think that the negotiation should last no more than two years. Personally, I think it can be done in a shorter period of time.

What is different from the efforts of previous Administrations?
Because in at least the last two Administrations, efforts began late in the term. This President appointed me two days after he was sworn in, and you know what he said to me? "I want you to go over there tonight." I said: "Mr. President, I've got a wife and kids. I don't have any clothes with me. I have to go home and tell them I'm going to leave."

You have been Senate Majority Leader, a district court judge, and it is said Bill Clinton was prepared to put you on the Supreme Court.
He offered the position to me.

And yet is this the most challenging, the most exciting thing that you have done in your professional life?
You left out steroids and Major League Baseball. Actually, this is very difficult. Let me tell you, it takes a lot of courage for these political leaders to operate in these circumstances. There are direct threats against them and their families.

O.K., you have lots of carrots. Do you have any sticks—other than saying: "Goodbye, take care of yourself, we're out of here"?
Yes, of course, but you have to be very careful about how and when you use them.

So you say to Israel, look, if you don't do this ... what?
Under American law, the U.S. can withhold support on loan guarantees to Israel. President George W. Bush did so on one occasion. But we think the way to approach this is to try to persuade the parties what is in their self-interest.

Why is President Obama's popularity so low in Israel? It's 4%.
I've heard the figure, but it's simply not true. A plurality supports him in Israel. | BW |

www.storemags.com & www.fantamag.com

20 Empty clawbacks?
21 Intel vs. Qualcomm
22 It's tablet time
23 Easing Ukraine's pain
24 Bond brawl in Argentina
25 Chavez, inflation fighter
26 Foreclosure in Dubai

COMMENTARY

The Crisis Commission's Missing Witness

To really get to the roots of the financial debacle, call Alan Greenspan and give him the third degree

By Paul M. Barrett

The public debut of the Financial Crisis Inquiry Commission on Jan. 13 featured Wall Street bosses striking alternately defensive and humble poses while pundits recalled the glory days of New Deal investigator Ferdinand Pecora. The contrition seemed mostly shallow, especially compared with the bankers' obvious impatience over the occasional sharp question. More important, it seems likely that the hopeful historical references to Pecora will ultimately prove disappointing.

One way the commission could salvage something meaningful from the hearing room theater would be to bear down on a former Washington player so far not on the witness list. That would be Alan Greenspan.

In the run-up to the commission's opening act, many commentators invoked Pecora, the peppery chief counsel who 77 years ago galvanized a Senate investigation of the 1929 crash. The Pecora Commission, as it came to be called, revealed abuses that showed Depression-era Americans just how much Wall Street was a semi-rigged casino. We will likely get some of the same as the Financial Crisis Inquiry Commission (and let's hope someone devises a catchier name soon) holds hearings in coming months.

The Pecora Commission also laid the groundwork for legislation establishing the Securities & Exchange Commission and insulating the staid depository and lending functions of commercial banking from the riskier trade in securities. That framework kept commercial banking relatively safe, if dull, for a half-century. Its bipartisan demolition, beginning in the 1980s, together with the purposeful demoralization of institutions such as the SEC, helped recreate a free-for-all, 1920s-style environment in the 2000s. You know what happened next.



January 1933: Banker Donald Durant is sworn in before a Senate panel

BETTMANN/CORBIS

Do not expect the bipartisan FCIC, chaired by Phil Angelides, a former California state treasurer, to rival the impact of Pecora. We will not see the likes of the Securities Act of 1933, the Glass-Steagall Act of 1933, and the Securities Exchange Act of 1934. This time around, Wall Street lobbyists got the jump on the legislative process. The major battles on Capitol Hill have already been fought, with only the details left to resolve.

After all of President Barack Obama's fulminating over the largely symbolic issue of investment banker bonuses, Wall Street is writing checks with just as many zeroes, and Congress isn't going to do anything about it. Obama and lawmakers bought the financial wizards' insistence that substantial curbs on derivatives speculation would somehow threaten the Republic. What we'll probably get instead is greater transparency for some, but not all, derivatives trading. This half-measure will allow new petri dishes of systemic risk to fester in darkness as Wall Street returns to the "financial innovation" laboratory. Congress is expected to make it easier for the government to step in once a financial conglomerate starts to fail. But the idea of revisiting

www.storemags.com & www.fantamag.com



January 2010: Blankfein, Dimon, Mack, and Moynihan take the oath

Glass-Steagall's separation of commercial banking from securities speculation never got past the daydreams of Paul Volcker, Obama's marginalized emissary from a distant and more commonsensical era of regulatory caution. The big three credit-rating agencies will continue to enjoy a government-blessed oligopoly while collecting fees from the very institutions whose securities they evaluate.

That's not to say that the commission will fail to examine some episodes of fraud, greed, and hubris. "We may well find criminal activity as well as egregious practices that were not only permitted but exalted," Angelides said on Jan. 13. The Wall Street CEOs conceded that things got out of hand, implying that all the really horrific stuff happened in some other guy's shop. "Too many financial institutions and investors simply outsourced their risk management," Lloyd C. Blankfein, chairman and CEO of Goldman Sachs, said in his opening statement.

Hearing room talk is one thing; real change, another. Ask the cigarette manufacturers. Representative Henry Waxman (D-Calif.) publicly sautéed their CEOs in 1994. A lot of lawsuits followed. But tobacco remains a very lucrative, very deadly business.

The best way for the commission to make a name for itself is not to focus solely on banker avarice and mortgage fraud—much of which has already come to light in the past year—but to conduct a symposium on the fundamental causes of our financial troubles. The two major ones: 1) the persistently low interest rates in the early 2000s that inflated the bubbles in housing and credit and 2) the notion that financial markets police themselves.

As the Fed's domineering chief from 1987 to 2006, Alan Greenspan enforced a hands-off orthodoxy based on the idea that government officials can't distinguish between markets overheating dangerously and prices rising because of economic fundamentals. Rather than prick bubbles too early, the Fed should do damage control after a crash, he told the Senate Banking Committee in July 1999: "Mitigate the fallout when it occurs, and, hopefully, ease the transition to the next expansion."

DON'T EXPECT 1930s-STYLE REFORM. THIS TIME, WALL STREET LOBBYISTS GOT THE JUMP ON THE LEGISLATIVE PROCESS

Following this strategy, Greenspan did little to address the Internet craze of the 1990s, which ended in a stock bust and recession. He and his colleagues mitigated the fallout by hacking interest rates and flooding the economy with cheap money. That seemed smart at the time; the recession of 2001 was relatively brief. But by keeping rates artificially low for several years, the Fed replaced the Internet stock bubble with a real estate bubble, as John Cassidy, economics correspondent for *The New Yorker*, observes in his instructive book *How Markets Fail* (2009). Faced with the ensuing consumer borrowing binge and soaring

KEVIN LAMARQUE/REUTERS

www.storemags.com & www.fantamag.com

home prices, Greenspan and his colleagues did nothing.

They also blithely ignored the manic leveraged gambling on Wall Street predicated on a fantasy of ever-rising real estate values. Investment banks could be trusted to keep one another honest, Greenspan said.

That turned out to be incorrect. Greenspan's legacy is having combined reckless easy money policies with even more reckless antiregulatory zeal, Richard A. Posner, the economist and federal judge argues in his forthcoming volume, *The Crisis of Capitalist Democracy*. Posner adds: "The regulators of money and banking—of monetary policy and financial intermediation—were asleep at the switch."

So I suggest that the crisis hearings quickly move to giving Greenspan the third degree. In his characteristically convoluted way, the ex-Fed chairman already conceded to Congress, in October 2008, that he had been naive about self-regulation. Let's get him to say it in plain English—and more than once. Hearing a discredited Greenspan concede grave error could possibly free Washington of his lingering influence; maybe it would even embolden a few more lawmakers to show some resolve in the face of Wall Street's formidable lobbying machine.

The commission could sit Greenspan's successor, Ben Bernanke, next to him at the witness table. Bernanke, who has agreed to testify, acknowledged in early January that regulatory failings contributed to the crisis. But since he was at Greenspan's right hand as a member of the Fed board for most of the crucial 2002-06 period, Bernanke's passive-voice implication that it was someone else's regulatory screw-ups that led to woe seems, well, inadequate. Even more disturbing, Bernanke continues to insist implausibly that low interest rates didn't feed the bubblefest.

A reincarnated Ferdinand Pecora would want to skewer a few dishonest mortgage peddlers and unmask reckless credit-default-swap jockeys. Some of that wouldn't hurt. But if the Financial Crisis Inquiry Commission wants to make its own name, the panel needs to expand its witness list by at least one. | BW |

EMPTY CLAWBACKS?

The tool for recouping bonuses remains untested

By Alexis Leondis and Margaret Collins

Many executives will find something extra in their 2009 bonuses: conditions on whether they can keep the money.

Of the 100 largest U.S. companies by revenue, 70 say they have so-called clawback provisions that allow them to recoup pay. That's up from 16 in 2006, according to Equilar, a compensation research firm. "The concept of a clawback is gaining credibility and frequency," says Kenneth Feinberg, the Treasury Dept.'s special master on executive compensation. "Whether it will be effective in promoting stability and growth remains to be seen."

Companies were under pressure to do something given the public outcry over supersized pay, especially at big banks. Some 75% of 1,000 Americans surveyed by Bloomberg in December said bailout recipients shouldn't give out bonuses. The Federal Deposit Insurance Corp. is looking at clawbacks, and Senate lawmakers want to make them mandatory at companies that issue inaccurate financial reports.

Rather than waiting for legislation, Goldman Sachs, Morgan Stanley, Motorola, Pfizer, Safeway, and others are putting clawback clauses into employment contracts. Some companies can rescind bonuses for excessive risk-taking. Others can recoup pay for unethical behavior. Executives may have to forfeit cash or stock up to four years after the payout. "There's no such thing as free money," said Liam O'Brien, managing partner at New York law firm McCormick & O'Brien.

Companies that have had clawbacks haven't used them much. That's because the process can be long and costly, particularly when an employee has spent the money or quit. Employers usually have to go to court or arbitration to enforce the rules. More companies, though, may be taking action. Last year there was a 57% jump in breach-of-contract arbitration cases, which sometimes involve clawbacks, according to the self-governing Financial Industry Regulatory Authority.

Recently regulators have been going after bonuses more aggressively. In July the Securities & Exchange Commission sued Maynard Jenkins, former CEO of car parts retailer CSK Auto, demanding that he forfeit $4.1 million he received from 2003 to 2005 when company employees allegedly inflated earnings. (Under the Sarbanes-Oxley Act, the agency can seize payments to top executives of companies that have inflated earnings or engaged in other misconduct.) It's the first time the SEC has gone after an executive who it hasn't accused of wrongdoing.



U.S. pay czar Feinberg doesn't know if clawbacks will deter risky behavior

Jenkins asked a court to dismiss the case. His attorney, John Spiegel of Munger, Tolles & Olson, said in a statement this summer that the SEC is "overreaching." Said Rosalind Tyson, director of the SEC's Los Angeles office, in a July statement: "Jenkins was captain of the ship and profited during the time that CSK was misleading investors. The law requires Jenkins to return those proceeds."

RICHARD CLEMENT/NEWSCOM

www.storemags.com & www.fantamag.com

Make That 'Qualcomm Inside'

Suddenly the cellphone chipmaker is everywhere, challenging mighty Intel on its own turf

By Olga Kharif and Ian King

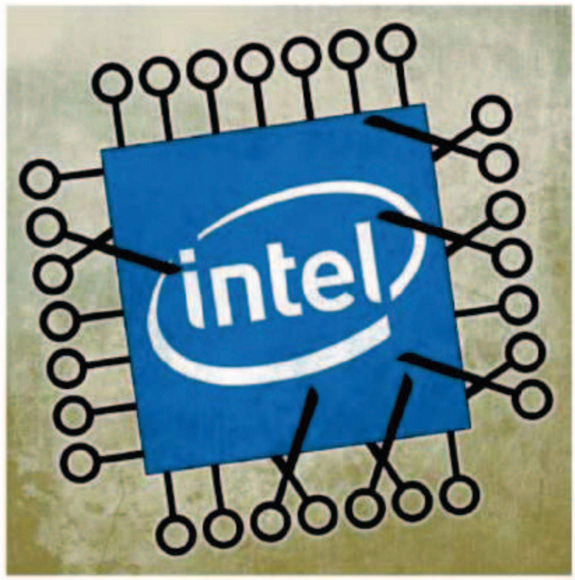
Behind the hoopla over the debut of Google's Nexus One is a quiet triumph for Qualcomm. That the San Diego company's chips are powering the smartphone is a sign of its continuing success in the mobile phone market. It's also a sign that Intel should watch its back.

Qualcomm is already the world's largest maker of cell-phone chips. But it's upping its dominance of that market just as Intel is making a foray into mobile phones. Later this year, Intel plans to release a smartphone processor called Moorestown, part of its Atom line of chips.

Even as Intel tries to catch up in the mobile phone market, Qualcomm is attacking on other fronts. While Intel has been busy serving traditional PC markets, Qualcomm has begun targeting the many new smaller computers now tempting consumers, including smartbooks and netbooks. Qualcomm's chips are under the hood of new machines from Hewlett-Packard and Lenovo. "Intel and Qualcomm are on a collision course," says Flint Pulskamp, an analyst at research firm IDC.

Both companies are looking to regain momentum after revenue declines during the recession. Qualcomm's revenues dropped 7% for the fiscal year ending in September, to $10.4 billion, while Intel's revenues are expected to slide 8% for 2009, to $34.7 billion, according to consensus estimates from Bloomberg.

Intel spokesman Bill Calder says the company sees robust demand for its Atom chips, which are designed for use in scaled-down computers and mobile devices. "We've shipped well in excess of 40 million Atom chips in netbooks and have over 80 design wins from every major [equipment maker]," he says.



THOMAS FUCHS

Qualcomm's big bet is on Snapdragon, the chip in the Nexus One. The company predicts that the chip eventually will be used in more than 40 devices made by 17 manufacturers. "Over the last two or three years, the partners that we deal with are new," says Steve Mollenkopf, a Qualcomm executive vice-president. "It used to be the phone guys. Now it's consumer electronics and phone guys."

In the first half of the year, Qualcomm plans to introduce faster versions of Snapdragon, almost closing the performance gap with some Intel processors. Analysts think that Apple, which now uses Samsung chips in its iPhone, may also begin using Qualcomm chips in some devices. "The last smartphone holdout, Apple, will embrace [Qualcomm] this year," wrote Brian Modoff of Deutsche Bank in a Jan. 7 report.

"INTEL AND QUALCOMM ARE ON A COLLISION COURSE" IN EVERYTHING FROM CELL PHONES TO SMARTBOOKS

Bolstering Qualcomm's assault on the chip market is the growing acceptance of the ARM technology in many of its chips. Created by ARM Holdings in Britain, the technology is used in chips primarily powering cell phones and, more recently, smartbooks, which are a bit smaller than netbooks. The number of smartbooks powered by ARM chips is expected to exceed the number of netbooks using chips from Intel and Advanced Micro Devices by 2013, according to IDC. Marvell Technology, Nvidia, Freescale Semiconductor, and Texas Instruments also use chip technology developed by ARM.

Intel says it's confident that demand for its chips will remain buoyant. "We've heard a lot about ARM-based netbooks for more than a year. But today it's very limited in what you can buy in the market," says Calder.

Intel, of course, has tremendous resources, including boatloads of cash that it has used in the past to leave rivals like AMD behind. On Jan. 4, the company unveiled its next-generation Atom processor and said it will be used in notebook designs from companies including Asus, Acer, and Dell. Intel has high hopes for cell-phone chips, too.

It is collaborating on mobile devices with Nokia, the world's largest maker of cell phones, and in early January showcased Moorestown chips in a phone by South Korea's LG. "Intel has deep pockets," Pulskamp says. "You never underestimate Intel." BW

www.storemags.com & www.fantamag.com

The Next Big Thing, 20 Years Later

The tech industry thinks the time is right for tablets, thanks to lower prices and friendlier features

By Spencer Ante

If there was a land of misfit gadgets, the tablet computer would be one of its oldest residents. The tech industry, though, refuses to give up on these slate-like portable PCs. Tablets from Hewlett-Packard, Dell, and others were some of the stars at this month's Consumer Electronics Show in Las Vegas, while the buzz around Apple's long-awaited entry into the market, due out this spring, is already deafening. "The industry understands better how people can use tablets," says Roger Kay, president of Endpoint Technologies Associates.

Yet PC makers have been trying to sell consumers on the utility of tablets for decades—with little success. In 2001, Microsoft Chairman Bill Gates predicted that tablets would be the most popular form of PC sold in the U.S. within five years; in 2009, they made up less than 1% of the market, according to estimates from research firm IDC.

The first generation was doomed by a combination of big price tags, short battery life, and clunky interfaces. Tablets' capabilities have since evolved, as have the tastes of consumers. Portability is paramount, and the latest crop are lighter, boast longer battery life, and better screen technology. Software is more sophisticated, too, and Web connections have improved. "The timing is right for this," says Philip McKinney, vice-president and chief technology officer of HP's Personal Systems Group. "We wouldn't go into a market that we felt wasn't going to be widely adopted."

Widely adopted remains to be seen. Widely served, however, is a certainty. In 2009, about 15 PC makers released tablets. This year, that number could top 30. Despite the wave of products, most analysts believe the success of the entire category hinges on Apple. Sanford Bernstein analyst Toni Sacconaghi estimates the Apple model alone could sell 3 million units in its first year—triple the total tablet sales worldwide in 2009.

That's because of Apple's knack for packaging elegant hardware with software and applications: iTunes drove sales of the iPod, while the App Store is fueling those of the iPhone. Now Apple is trying to convince studios and publishers to format movies, books, and magazines for its latest device.

Getting phone companies to offer new and affordable Internet service plans to support a data-guzzling tablet could prove even more challenging. Currently, Wi-Fi service is too spotty outside the home to make a tablet experience rich, and many consumers are leery of spending $60 a month for a mobile broadband plan. "Connectivity remains a big problem," says IDC analyst David Daoud. "Apple has done pretty fantastic things and maybe they can figure it out." | BW |

THE ORIGIN OF SPECIES: HOW TABLET PCs HAVE EVOLVED



GRIDPAD

Introduced: 1990

Price: $2,500

This early ancestor featured a stylus for on-screen writing and sold 10,000 units before a lack of software applications and a high price doomed it to extinction.

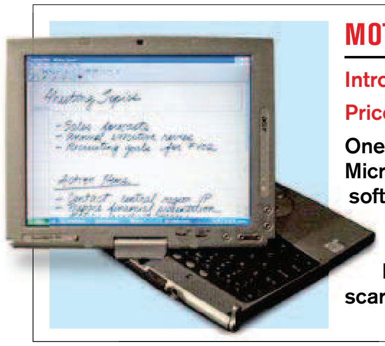


APPLE MESSAGEPAD

Introduced: 1993

Price: $700

Although it was dubbed a personal digital assistant, Apple's MessagePad was a tablet precursor. The device, better known as the Newton (after its operating system), suffered from poor handwriting recognition.



MOTION COMPUTING M1200

Introduced: 2002

Price: $2,199

One of the first gizmos to run Microsoft's Windows Tablet PC software, this elegant machine earned positive reviews, but the steep price, scant battery life (4 hours), and heat buildup scared away prospective buyers.



HEWLETT-PACKARD TOUCHSMART TM2 TABLET

Introduced: 2010 (January)

Price: $949

HP's latest sub-$1,000 tablet features a multitouch interface, a power-sipping Intel chip, and a swiveling keyboard for those who don't like the touchscreen technology.

(CLOCKWISE FROM TOP LEFT) COURTESY THE COMPUTER HISTORY MUSEUM; DANIELE MELGIOVANNI/SSPL/GETTY IMAGES; COURTESY HP; RON WURZER/GETTY IMAGES

www.storemags.com & www.fantamag.com



Ahead in the polls, Yanukovych seeks better ties with both Moscow and Europe

Can Ukraine Say *Nyet* To Political Squabbles?

If presidential elections usher in stability in Kiev, the economy stands a chance of returning to growth

By James M. Gomez and Daryna Krasnolutska

It's not even February yet, and 2010 is shaping up to be a bad year for Viktor Yushchenko, who survived a poisoning attempt by political opponents in 2004 and went on to be elected president of Ukraine. Voters are tired of Yushchenko and seem far fonder of two other candidates vying to succeed him this week: opposition leader Viktor Yanukovych and populist Prime Minister Yulia Timoshenko.

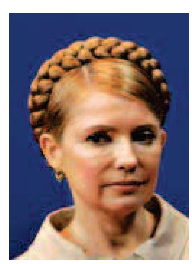
Yushchenko, 55, feuded with Russia and cozied up to the U.S. and the European Union, so should Western policymakers and investors be worried about a Ukraine tilted more toward Moscow? Probably not. Both Yanukovych, 59, who is ahead in the opinion polls, and Timoshenko, 49, say they want better ties with both Moscow and Europe. Political stability under a new president could unfreeze a $16.4 billion bailout loan from the International Monetary Fund, ease conflicts with Russia, and improve the prospects for a free-trade accord with the European Union, predicts Sacha Tessier-Stall, head of foreign policy at Kiev's International Centre for Policy Studies. "No matter who wins, there will be an improvement," he says.

The election may also improve Europe's energy security. The EU relies on Russia for a quarter of its natural gas, and 80% of that passes through Ukraine, a country of 46 million that's about as big as France. Disputes over prices led Russia to turn off the gas to Ukraine in January 2006 and January 2009, which in turn caused fuel shortages in the EU. In November, Timoshenko and Russian Prime Minister Vladimir Putin renegotiated the two countries' gas contract for 2010, easing concerns about a shutoff. "The risk to Europe has decreased," says Gergely Varkonyi, an energy analyst at Deutsche Bank in Budapest.

With 18 candidates competing, no one is likely to gain the 50% majority needed to win outright. That means Yanukovych and Timoshenko will likely face each other in a runoff on Feb. 7. Whoever emerges triumphant already knows how bad the path forward is. Ukraine's gross domestic product shrank an estimated 14% in 2009. The country's currency, the hryvnia, was the world's worst performing vs. the U.S. dollar in the year ended in September. And Ukraine is the world's second-least creditworthy economy behind Argentina (page 24), as measured by the cost of credit-default swaps that protect bondholders.

High on the agenda for the new president will be unfreezing IMF money. Ukraine secured the loan in late 2008 after the global credit crisis crippled its exports and financial sector. But the IMF delayed a $3.4 billion installment in November after lawmakers failed to pass a 2010 budget while raising social spending. "The political infighting that has paralyzed the country has to stop," says Jorge Zukoski, president of the American Chamber of Commerce in Ukraine.

If Ukraine stabilizes its politics after the election, the country stands a chance of returning to growth. That could give foreign investment a boost. Since Yushchenko took over the presidency in early 2005, Ukraine has attracted some $36 billion in foreign direct investment from companies such as Luxembourg's Arcelor-Mittal, Italy's UniCredit Group, and French retailer Groupe Auchan. Between 1999 and 2004, the country pulled in just $5.7 billion in foreign direct investment.



Timoshenko hammered out a gas deal with Russia, easing fears of shortages

Under Yushchenko, the country won membership in the World Trade Organization and the EU declared Ukraine a market economy. Now, both Yanukovych and Timoshenko support signing an association agreement with the EU, which includes a free-trade pact. Says Ivan Tchakarov, an emerging markets analyst at Nomura Holdings in London: "Ukraine can be a positive surprise this year." BW

(TOP TO BOTTOM) PHOTOGRAPHS BY YURIY DYACHYSHYN/AFP/GETTY IMAGES; VIRGINIA MAYO/AP PHOTO

www.storemags.com & www.fantamag.com



PRAKASH SINGH/AFP/GETTY IMAGES

Reasons to Cry For Argentina

An attempt to pay off creditors sparks a feud with the central bank—and now a constitutional crisis

By Geri Smith

For the better part of a decade, overseas investors have viewed Argentina as a pariah: After a currency collapse in 2001, the country suspended payments on some $95 billion in foreign debt—the largest sovereign default in history. Then in 2005, the government offered creditors, ranging from Italian pensioners and American teachers' unions to Wall Street hedge funds, just 30¢ on the dollar if they agreed to swap their old bonds for new notes. About three-quarters of the debt holders grudgingly accepted the deal.

So it should be good news that Argentine President Cristina Fernández de Kirchner is trying to return to the good graces of the global investment community. In December she said she would set up a fund backed by reserves at the Banco Central de la República Argentina to guarantee future foreign debt payments. She's also preparing to offer the thousands of remaining holders of the older bonds—investors such as the Kansas Cattlemen's Assn., the Nebraska Association of Retired School Personnel, and vulture funds that bought in after the default—another chance to swap them for new notes at the same steep discount offered in 2005. The goal is to restore her government's access to financing and tap into global demand for debt that pays higher yields than U.S. and European treasury bonds.

"WHAT WE REALLY HAVE IS A POLITICALLY WEAKENED GOVERNMENT DESPERATE TO GET FUNDS TO KEEP SPENDING"

Eyes left: Expenditures have jumped 30% annually on Kirchner's watch

But in her attempts to mollify investors, *la presidenta* is facing criticism at home and abroad. The central bank chief refused to hand over the $6.6 billion in reserves Kirchner had requested for the fund, and Congress accused the president of raiding the bank so she can continue to pump up spending. "Right when Argentina should be showing investors how capable and solid its strategy is, the different branches of government are fighting," says Esteban Fernández Medrano, an economist with consultancy Global Source Partners. On Jan. 12, creditors holding out for better compensation on the defaulted bonds persuaded a U.S. judge to freeze Argentine government funds on deposit with the U.S. Federal Reserve.

Kirchner's move has sparked a constitutional crisis. On Jan. 7 she fired Martin Redrado, the Harvard-educated head of the central bank, and tried to replace him with a deputy more amenable to her plan. The next day

www.storemags.com & www.fantamag.com

a judge ordered Redrado reinstated, arguing that only Congress can remove him. Congress, in recess until March for the Southern Hemisphere summer holidays, is considering an emergency session to resolve the dispute.

Kirchner has lavished billions of dollars on subsidies for food, fuel, and electricity, sending state expenditures up by some 30% annually since she took office two years ago. The problem is, tax revenues have been rising just 12% annually, so a comfortable fiscal surplus has become a deficit equivalent to 2.5% of gross domestic product over the past two years. To make up the shortfall, Kirchner tried in 2008 to raise export taxes sharply on soybeans and other grains. That led to a four-month standoff with farmers before she backed off. Later that year she nationalized some $30 billion in private pension funds, adding the resources to the Treasury and forcing millions of Argentines to join the government's pay-as-you-go social security system.

SHORT MEMORIES

Such moves contributed to the defeat of Kirchner's Peronist party in last year's mid-term elections. With a presidential vote looming in 2011, Kirchner is eager to shore up support. "What we really have here is a politically weakened government that's desperate to get funds to keep spending," says Daniel Kerner, an analyst with political risk consultancy Eurasia Group.

Even if she manages to win her battle with the central bank, some bondholders may shun the swap—and present more legal challenges to Argentina's efforts to raise funds internationally. But others will be eager to collect some interest on their long-defaulted bonds. If Kirchner manages to persuade the bulk of the holdouts to go along with the debt swap, plenty of international investors in search of high returns are likely to find their way back to Buenos Aires. "One lesson in emerging markets is that memories are short," says Ignacio Sosa, a portfolio manager for Vorás Capital Management. "If the yield is attractive enough, people will invest in Argentina again." |BW|

—With Drew Benson in Buenos Aires

GUESS WHO LIKES THE DOLLAR

With inflation soaring, Chávez finally devalues the bolívar

By Peter Coy

Hugo Chávez regularly gets ripped by international economists for his interventionist and abrupt economic policies. Yet the Venezuela president's latest move to devalue the national currency has a certain logic. It might help stabilize the nation's finances and boost domestic producers, which have been hit by competition from imported goods subsidized by an artificially pumped-up currency.

A devaluation was long overdue, even though Chávez had repeatedly denied one was in the works. Years of 20% inflation rates caused by government overspending has eroded the value of the bolivar in international currency markets. The current black market exchange rate is more than 6 bolívars for 1 U.S. dollar. Officially, though, the exchange rate has been stuck at 2.15 bolívars to the dollar since 2005.

As a result, anyone who could buy dollars at the official rate was able to import, say, Japanese wide-screen TVs relatively cheaply and resell them at a tidy profit. The artificially low price for dollars also created a shortage of them inside Venezuela, crimping domestic manufacturers that need dollars to buy critical components.

By bringing the bolívar closer in line with its market value, "the government is reducing a distortion," says Alejandro Grisanti, a Venezuelan economist at Barclays Capital in New York.

Devaluations are never popular, because no one likes to lose purchasing power. So Chávez made some distinctions. He announced a 21% devaluation, to 2.6 bolívars to the dollar, for essential imported goods, such as food and health-care items, but a 50% devaluation, to 4.6 bolívars to the dollar, for nonessential items. Anticipating price increases, consumers in major cities such as Caracas rushed to buy electronic goods and appliances. The hope, however, is that exchange rate adjustments will cause a one-time reset of consumer prices rather than exacerbate long-term inflation. Once import prices rise to reflect the new exchange rates, their contribution to inflation will end.

None of this means Chávez has suddenly embraced free-market capitalism. He sent inspectors, accompanied by soldiers, to shut down stores that raised prices, even though price increases on imported products are probably needed.



Behind schedule? Chávez's failure to devalue sooner helped create a dollar shortage

THOMAS COEX/AFP/GETTY IMAGES

"The bourgeois are already talking about how all prices are going to double," he said on state television during his weekly *Aló Presidente* program. "People, don't let them rob you."

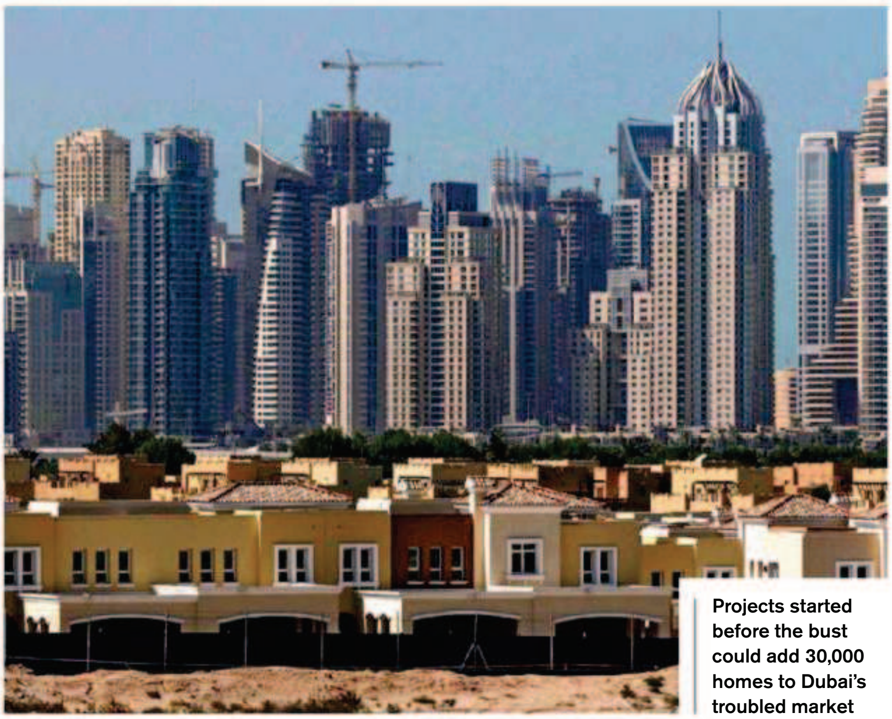
More worrisome was an announcement by Chávez that Venezuela's central bank will transfer a higher-than-expected $7.8 billion of international reserves to cover the government deficit. Such transfers will enable more deficit spending, causing higher inflation—and inevitably, more devaluations to come.

—With Daniel Cancel in Caracas

www.storemags.com & www.fantamag.com

Dubai: The First Foreclosure

Barclays' landmark case paves the way for other lenders to go after homeowners in default



Projects started before the bust could add 30,000 homes to Dubai's troubled market

By Zainab Fattah

With plunging values, missed mortgage payments, and abandoned homes, Dubai's housing market is a lot like others around the world. Except for one thing: There have been no foreclosures in the emirate. Until now.

Barclays recently won the sheikdom's first foreclosure case in a local court. The decision, based on a 2008 law, paves the way for others to pursue claims. Lenders hold $16 billion of residential mortgages. Tamweel P.J.S.C., Dubai's biggest mortgage bank, has several foreclosure cases pending. "Banks will be more aggressive," says Antoine Yacoub, a Dubai-based banking analyst at Moody's Investors Service. "Once they see a precedent has been set, they will be encouraged to push more cases through."

For much of the past decade the emirate was one of the world's hottest property markets. Residential real estate prices quadrupled from 2002—the year Dubai first allowed foreign residents to own property—to mid-2008. The boom was fueled by a growing expatriate workforce and speculation. Prospective buyers routinely stood in long lines to snag homes in new developments, even before construction began. Investors frequently flipped apartments, using profits to buy more properties. Some apartments changed hands two or three times before ground was broken.

The global financial crisis has sent Dubai property values down 52% over the past year, says Deutsche Bank. High-rises stand empty. Some foreign residents who can't pay their mortgage bills have simply abandoned their homes and fled the country, ditching their cars at the airport parking lot. That's because borrowers are required to write postdated checks when they take out a home loan—and people until recently could be jailed for bouncing a check in Dubai. Some 12% of the 27,000 residential mortgages in the sheikdom could go into default within 12 to 18 months, according to September estimates by Moody's.

Not long ago there was no formal system for dealing with defaults. Lenders avoided the courts, discouraged by the ambiguity of the legal process and a culture that frowns on forcing people from their homes. To help buyers, lenders usually try to work out troubled loans, extending payment terms or allowing borrowers to return some of their investment properties. Even so, many loans have been left in limbo.

The 2008 law should impose some structure on the process. It requires lenders to give homeowners 30 days' notice of their intent to pursue foreclosure. If the court finds in favor of the lender, Dubai's Land Dept. auctions off the property, with the proceeds going to pay off the loan.

Lenders may be selective in using the new law. Britain's Standard Chartered Bank, a big mortgage lender in Dubai, says foreclosure is "a legitimate course of action" but not its "preferred approach." As in the U.S., banks are reluctant to dump foreclosed properties on the market for fear of driving down prices, says Saud Masud, a Dubai-based real estate analyst at UBS. New projects, started before the bust, will add up to 30,000 housing units to the market in 2010, according to Deutsche Bank. "Mass auctions may reprice the property market in a meaningful way," Masud says. "It's a slippery slope." |BW|

12%

The share of Dubai's 27,000 residential mortgages that could go into default within 12 to 18 months

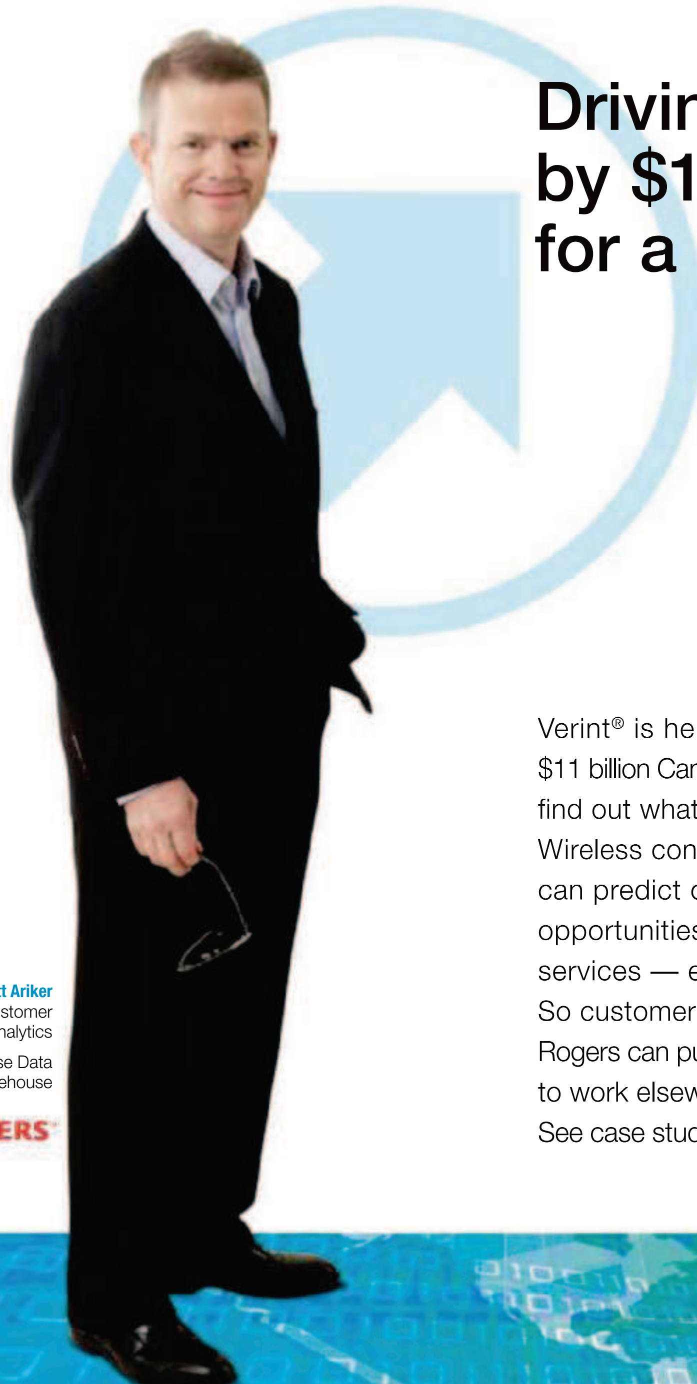
Data: Moody's Investors Service

CHARLES CROWELL/BLOOMBERG NEWS

www.storemags.com & www.fantamag.com

Driving up customer satisfaction by 30% makes for a good day.[1]

Driving down costs by $180 million makes for a really good year.[2]



Matt Ariker
VP, Customer Management & Analytics
VP, Enterprise Data Warehouse
ROGERS

Verint® is helping Rogers Communications, an $11 billion Canadian communications and media company, find out what's driving customer calls into the Rogers Wireless contact center. With this insight, Rogers can predict customer behavior patterns, identify opportunities to improve strategy, products, and services — even transfer calls more accurately. So customers can enjoy a better experience, and Rogers can put up to $180 million in projected savings to work elsewhere. That's **Intelligence In Action**.™ See case studies at **www.intelligenceinaction.com**.

VERINT

Intelligence ***in Action***™

© Copyright Verint Systems Inc. 2010. All Rights Reserved Worldwide. 1 Customer satisfaction among customers waiting for handset delivery. 2. Identified cost savings for potential realization.

www.storemags.com & www.fantamag.com



V

www.storemags.com & www.fantamag.com

S



How the battle between Silicon Valley's superstars will shape the future of mobile computing

By Peter Burrows

Photo-Illustration by David Rudes/BW

www.storemags.com & www.fantamag.com

On Jan. 5, Google did a very Apple-like thing. In a presentation at the Googleplex in Mountain View, Calif., the 11-year-old search behemoth unveiled Nexus One, a stylish touchscreen smartphone that runs on the company's Android operating system, is sold through a Google-operated retail Web site, and greets the market with an advertising tagline ("Web meets phone") as simple and optimistic as the one Apple used in 2007 to introduce its iPhone ("The Internet in your pocket").

On the same day, Apple did a very Google-like thing. Steve Jobs, the king of splashy product launches and in-house development, announced a strategic acquisition. For $275 million, Apple purchased Quattro Wireless, an upstart advertising company that excels at targeting ads to mobile-phone users based on their behavior.



Schmidt gave up his Apple board seat due to increasing conflicts

When companies start to imitate one another, it's usually either an extreme case of flattery—or war. In the case of Google and Apple, it's both. Separated by a mere 10 miles in Silicon Valley, the two have been on famously good terms for almost a decade. Jobs and Google CEO Eric Schmidt, both 54, spent years in separate battles against Microsoft while Schmidt was at Sun Microsystems and Novell. Over time, they went from spiritual allies to strategic ones. When Apple had an opening on its board in 2006, Jobs tapped Schmidt. "Eric is obviously doing a terrific job as CEO of Google," Jobs said at the time. Schmidt, meanwhile, called Apple "one of the companies in the world that I most admire."

Tensions in Silicon Valley's special relationship began to emerge in late 2007, when Google announced plans to develop Android for mobile phones. Apple had unveiled its iPhone in January of that year, and it was clear that the two companies would spar in the smartphone business. Still, both were niche players, with more formidable rivals in companies like Nokia, Samsung, and Research In Motion. Only after software developers began creating thousands of mobile apps, and it became clear that phones would become the computers of the future, did the conflicts begin to grow serious. Last summer, Apple refused to approve two Google apps for sale to iPhone users, raising questions about how much of a Google presence Apple would allow on its devices. In August, Schmidt gave up his board seat. "Unfortunately, as Google enters more of Apple's core businesses," Jobs said at the time, "Eric's effectiveness as an Apple board member will be significantly diminished, since he will have to recuse himself from even larger portions of our meetings."

Now the companies have entered a new, more adversarial phase. With Nexus One, Google, which had been content to power multiple phonemakers' devices with Android, enters the hardware game, becoming a direct threat to the iPhone. With its Quattro purchase, Apple aims to create completely new kinds of

(PREVIOUS PAGE) NEXUS ONE PHOTOGRAPH BY TOM SCHIERLITZ/GOOGLE/MCT; (THIS PAGE) PHOTOGRAPH BY KEVIN LORENZI/BLOOMBERG; ICONS BY MARK NERYS

COLLISION COURSE

Apple and Google, once close allies, are battling on a growing number of fronts

SMARTPHONES



Apple has ridden the iPhone to 14% of the smartphone market in three years. Google's original plan to let hardware partners make phones running its Android software has garnered only a sliver of the market. So Google, risking the ire of Android phonemakers, is launching its own Nexus One phone.

MOBILE SOFTWARE



The 125,000 apps iPhone users can download bolster the popularity of Apple devices and give it influence over how people use their phones. Rather than use Google's search, iPhone users can fire up the *New York Times* app for news or Yelp for local restaurants. Google is well behind with 18,000 Android apps.

ADVERTISING



Google's core business is advertising, with virtually all of its revenue coming from the text ads that pop up alongside search results. Apple aims to break into the mobile advertising business Google has been eyeing by creating new ways to advertise within apps on the iPhone and other Apple devices.

www.storemags.com & www.fantamag.com

mobile ads, say three sources familiar with Apple's thinking. The goal isn't so much to compete with Google in search as to make search on mobile phones obsolete. "Apple and Google both want more," says Chris Cunningham, founder of the New York mobile advertising firm Appssavvy. "They're gearing up for the ultimate fight."

Apple spokeswoman Katie Cotton declined to comment on the company's advertising plans or its relationship with Google. Google spokeswoman Katie Watson said the company would not make executives available for this story. She did provide a statement, attributed to Vic Gundotra, Google's vice-president of engineering: "Apple is a valued partner of ours and we continue to work closely with them to help move the entire mobile ecosystem forward."

THE MOVE TO MOBILE

The tech industry has had its share of legendary rivalries: IBM vs. Digital Equipment Corp., Microsoft vs. Netscape, America Online vs. Yahoo! Apple vs. Google could dwarf them all. Both companies are revered by consumers with a passion usually reserved for movie stars and pro athletes. They have multibillion-dollar war chests, visionary founders, and ambitions for smartphones, Web browsers, music, and tablet computers that set them on a collision course.

The key battleground in the near term is mobile computing. Analysts who once tingled when talking about the Internet are getting that same old feeling over mobile's potential. Morgan Stanley's Mary Meeker predicts that within five years more users will tap into the Internet via mobile devices than desktop PCs. Desktop Internet use led to the rise of Google, eBay, and Yahoo, but the mobile winners are still emerging. "Now is the time to get going," says Doug Clinton, an analyst with Piper Jaffray. "It's about winning the battle today rather than getting into the fight tomorrow." Billions of dollars are up for grabs in selling phones, software, and services.

The money in mobile advertising is small—about $2 billion last year, according to researcher Gartner, compared with $60 billion for the overall Web. But figuring out how to make mobile advertising more profitable is a lot more important than merely getting in as the hockey-stick curve begins to move upward. A company that can nail mobile ads and share the wealth with the growing legion of app developers—freelance software writers who create all those sometimes-useful (Business Card Reader), sometimes time-killing (Flick Fishing) mobile programs—could pull in the best of the lot. Create the strongest ecosystem of apps and devices, and, the thinking goes, you leave rivals gasping to keep up. "The mobile platform that creates the most ways to make money wins," says David Hyman, chief executive of MOG, an Internet music service that's developing mobile apps.

Apple has a substantial lead in establishing this ecosystem. Developers have created more than 125,000 mobile applications for Apple devices—seven times as many as exist on Android—and the endless diversity of apps has helped the iPhone quickly pick up 14% of smartphone share, compared with 3.5% for all the Android-powered devices put together, according to estimates by the market research firm IDC. But in the past few months, an increasing number of app developers have complained that they couldn't make money on their work. Free apps have become the norm, and very few sell for more than 99¢. Some developers have profited by embedding ads in their



Jobs believes app development is crucial to keeping iPhone sales brisk

TONY AVELAR/BLOOMBERG

PERSONAL COMPUTERS



Apple still gets almost 40% of its revenue from Mac computers running its operating system. Now Google is developing Android to run competing machines and has designed a separate operating system, Chrome OS, for simpler computer Web surfing. Both companies will soon back tablets, too.

ENTERTAINMENT



While Apple has become the world's largest music retailer, Google just began using its search engine to direct people to Apple rivals to play and buy songs. Google owns YouTube, and Apple is adding more video to iTunes, reportedly including a push to offer cable-like subscriptions to shows from CBS, ABC, and others.

ACQUISITIONS



Apple and Google, with $23 billion and $22 billion in cash and short-term securities, respectively, are competing increasingly for the same startups. Google won out in bidding for the ad service AdMob, then Apple outbid Google for the music site LaLa Media last year. Apple is adding people and processes to better compete for deals.

www.storemags.com & www.fantamag.com

apps, but the payments tend to be insignificant since the ads are usually smaller, less effective versions of their Web banner forms. According to a source familiar with his thinking, Jobs has recognized that "mobile ads suck" and that improving that situation will make Apple even harder to beat.

Not one to shy away from a challenge, particularly when it offends his aesthetic sensibilities, Jobs and his lieutenants have discussed ways to overhaul mobile advertising in the same way they had revolutionized music players and phones, say two sources close to the company. The sources did not reveal specific plans at Apple but say there are several possible ad approaches. Apple could employ its user data and geo-location technology to make ads more relevant, so that a user cruising the mobile Web at lunchtime could receive an ad for specials at a nearby restaurant. It could also use the iPhone's capabilities in creative ways—say, having someone shake the device to win a rebate the same way they do to roll dice in games.

To pull any of this off, Apple realized that it needed a network of advertisers and the technology to target ads to customer behavior. In fall 2009, Apple entered the bidding for AdMob, the leader in the nascent mobile advertising industry. It was a target that made perfect sense; more than half of the AdMob ads served up on smartphones ended up on the iPhone or iPod Touch (which also run Apple's apps). But before Apple could close the deal, Google intervened, announcing on Nov. 8 that it would pay a staggering $750 million for the company.

Outbid on its first choice, Apple quickly turned to Waltham (Mass.)-based Quattro Wireless, AdMob's closest rival. Tellingly, when Apple announced the deal, Jobs gave Quattro CEO Andrew Miller the title of vice-president of mobile advertising. Vice-president is a rare title at Apple, and Miller is the first one ever assigned to online advertising. Apple has also hired an M&A specialist to better compete for deals (box).

APPLE HAS VALUABLE MARKET DATA THAT WILL ENABLE IT TO BLEND ADVERTISING AND E-COMMERCE

For almost any company, taking on Google in search advertising would be folly. Google dominates traditional search with more than 65% of the market, and its share of search on mobile phones is even more imposing. More than a million businesses bid on keywords to show up alongside search results, and most experts have assumed a migration to mobile devices as more people use them for computing tasks.

Yet mobile search hasn't taken off. Gartner estimates that $924 million was spent on mobile search ads worldwide last year, less than 2% of overall Internet advertising. The problem

IS APPLE READY TO GO SHOPPING?

The company has hired a Goldman banker and become a bit more acquisitive

By Peter Burrows

Historically, Steve Jobs has not been the acquisitive type. Since he returned to Apple as chief executive in 1997, the company has bought only 11 small companies, far fewer than Silicon Valley counterparts such as Cisco Systems or Hewlett-Packard. Google has bought 11 companies in just the past 18 months.

Last year, Apple quietly hired a Goldman Sachs investment banker, Adrian Perica, to help the company cut deals. Multiple sources close to Apple say they believe Perica is the first dedicated M&A specialist on staff. The company has also stepped up its pace of acquisitions: Three of Jobs' 11 deals have come in the past five months, including the $275 million purchase of Quattro Wireless, the largest buy since Jobs' return. "Given Apple's strong stock price, it is in a position to be generous [in doing deals]," says Michael Kwatinetz, a general partner with venture capitalists Azure Capital Partners in the Valley. Apple spokeswoman Katie Cotton declined to comment on the company's acquisition strategy or whether it has had deal specialists on staff in the past.

Jobs has long preferred for his company to develop technology in-house and avoid the risks that come with integrating other companies into Apple's unique, finely tuned culture. In the past, there was no organized M&A effort, say three former executives at the company. Instead, business chiefs were supposed to keep an eye out for deals and go to Jobs if they thought there was a beneficial one to be made. After getting Jobs' O.K., the champion of the idea would pull together a team to make an overture, negotiate terms, and work through the administrative details. "It was super ad hoc," says one of the former executives.

But Apple lost out on a deal last year, in part because of its improvisational approach. As the company was negotiating with the mobile advertising firm AdMob last fall, Google swooped in and quickly bought the company for $750 million.

Perica helped make sure Apple didn't make the same mistake with its next deal, say four sources familiar with the situation. Late last year, Apple entered the bidding for the online music site Lala.com, after Google and several

www.storemags.com & www.fantamag.com

is that user behavior isn't consistent between desktops and mobile devices. Many people shy away from calling up minuscule search bars on their phones and pecking out queries using cramped keyboards. Search ads tend to be less effective, too, since people are reluctant to give over the one browser screen they have on a phone to an ad. In many cases, apps are far more effective; it takes fewer steps to find the best local sushi joint using apps from Urbanspoon or Yelp than to type out "best local sushi" into a search bar and navigate the results. "Eric Schmidt has said that the search problem is 99% solved, but, boy, is that self-serving," says Jonathan Yarmis, research fellow with the consulting firm Ovum. "The fact that I have to go to a search bar at all is a sign of failure."

Apple has a vault of valuable data that can help drive an ad business. It knows precisely which apps, podcasts, videos, and songs people download from iTunes; in many cases it has detailed customer information such as credit-card numbers and home addresses. That gives Apple a chance to blend advertising and e-commerce in new ways, particularly after the acquisition of Quattro. The startup already works with advertisers, including Ford, Netflix, and Procter & Gamble, to help them figure out when and where to place ads on the sites of publishers, such as *Sports Illustrated* and CBS News. By tying Quattro's ad-serving technology into its own, Apple would be able to tell advertisers how often and under what circumstances a person clicked on particular ads. "Apple is one of the few brands that could actually go head to head with Google," says Kevin Lee, chief executive of search marketing firm Didit. The technology could also be used on the tablet computer that Apple is expected to introduce later this month.

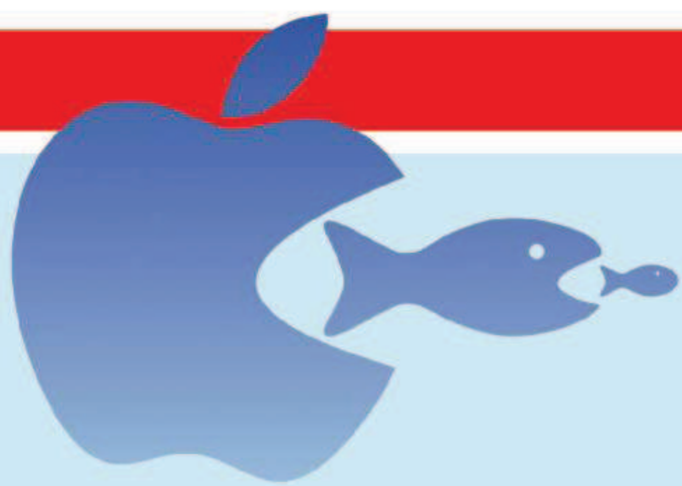
SAFETY IN NUMBERS

When Google introduced Android in 2007, the company said it would concentrate on developing the operating system software and let traditional phone manufacturers, such as Motorola and HTC, make the devices. The strategy was similar to Microsoft's in personal computers, aimed at working with dozens of partners to attack every product area, geography, and demographic. "One or two devices don't matter," said Andy Rubin, head of Google's Android business, after the Nexus One event. "Twenty or thirty or a hundred devices, all running the same software—that's what matters."

Yet the arrival of Nexus One suggests that Google is concerned Android isn't gaining market share fast enough. "The volume, quality, and variety of Android phones in the market today has exceeded our most optimistic expectations," said Google Product Management Vice-President Mario Queiroz at the January announcement. "But we want to do more." The mobile market is so important that Google can't afford to depend on other companies for access; the Nexus One offensive, Google hopes, will establish a foothold in smartphones so the company can control its own fate.

Nexus One isn't without risk. Android hardware makers

MARK NERYS



other potential acquirers had gotten involved. The company moved unusually quickly, closing the deal in a few weeks, rather than the more typical two to three months. It was clear that Apple didn't want to lose out again, and especially not to Google. "They've always gone slow on M&A, but that's changing," says one Silicon Valley banker.

Perica has a reputation for being direct and likable. He graduated from West Point and was a U.S. Army officer before joining Goldman. While he doesn't report directly to Jobs and is not part of Apple's most senior team, "he brings a DNA that's not native to Apple," says an investment banker who has worked with the company.

There are obvious strategic reasons Apple might want to become more acquisitive. The company is moving beyond its traditional base in personal computers and charging into smartphones and mobile computing. As mobile computing takes shape, Apple, Google, Nokia, and other traditional tech titans have become more active in searching for startups that can help them with the new terrain. In Apple's case, it has a war chest of $23 billion in cash and short-term securities to pursue acquisitions. "Their [business] model is evolving, and you can expect them to broaden their horizons," says Bill Whyman, an analyst with International Strategy & Investment.

Many experts believe Apple still won't be making any huge deals—the multibillion-dollar, headline-grabbing transactions other companies specialize in. Whyman says Apple has been an "organic grower" and will likely keep its acquisitions small. Rich Geruson, a former Nokia executive who sits on the boards of seven startups, says big companies like Google often wait to acquire a startup in an emerging field until they see which one is the most dominant. But that's not Apple. "The pattern I've seen with Apple is that they buy very, very small companies," he says.

www.storemags.com & www.fantamag.com

may balk at having to compete with their supposed partner. "If the Nexus One is any good, why would you buy anything else?" says Edward J. Zander, Motorola's former CEO, who is surprised Google would go so far as to enter the hardware fray. "At least Microsoft never built PCs."

Meanwhile, Google is aware of its vulnerability in mobile advertising and is pushing to make improvements. Schmidt believes mobile ads will one day be more important than PC advertising, largely because of personalization and localization. Although Google declined to discuss its plans for this story, Schmidt has floated the idea that eventually some mobile phones could be free for consumers, with advertising paying the bills. "If Google could do that, they'd be untouchable," says tech consultant John Metcalfe, who has worked with Google on mobile projects. "Apple wouldn't be able to come up with an answer for that."

THE SAME, BUT DIFFERENT

	GOOGLE	APPLE
Date Founded	1998	1976
CEOs	Eric Schmidt	Steve Jobs
CEO salary	$1 a year	$1 a year
Headquarters	The Googleplex, Mountain View	Infinite Loop campus, Cupertino
Market cap	$186 billion	$190 billion
Revenue*	$22.6 billion	$36.5 billion
Motto	Don't be evil	Think different
Key to success	Algorithms	Elegance
Work ethic	20% of employees' time for pet projects	120% of employees' time for Steve's projects
The employees who matter	Engineers	Designers
How decisions get made	Data, data, data	Because Steve says so
Founders' aircraft	Boeing 767	Gulfstream V
Car of choice	Toyota Prius	Mercedes SL55
Big challenge	Can they make money on anything but search?	Does anyone but Jobs have a vision?

Data: Bloomberg as of Jan. 13 *for the 12 months ending Sept. 30

Of course, Apple and Google could both end up thriving as computing goes mobile. But there will be losers. Microsoft is fading fast in smartphones as device makers shift attention away from Windows Mobile, which doesn't have nearly as many apps or developers as Android and Apple. Nokia, the world's largest mobile-phone maker, is struggling too; its Ovi online store toils in near-anonymity compared with Apple's iTunes store. Even Samsung and LG Electronics, Korean phonemakers long hailed for their advanced technology, are losing ground. "The older cell-phone makers never had to deal with software or software developers," says Shaw Wu, an analyst with Kaufman Bros. "It's just not in their DNA. [But] the world is moving that way."

BING IN THE WINGS?

Some analysts believe the Apple-Google battle is likely to get much rougher in the months ahead. Ovum's Yarmis thinks Apple may soon decide to dump Google as the default search engine on its devices, primarily to cut Google off from mobile data that could be used to improve its advertising and Android technology. Jobs might cut a deal with—gasp!—Microsoft to make Bing Apple's engine of choice, or even launch its own search engine, Yarmis says. "I fully expect [Apple] to do something in search," he adds. "If there's all these advertising dollars to be won, why would it want Google on its iPhones?"

Whatever happens, it's clear that Apple and Google are headed for more conflict. Android is a threat to an iPhone business that has quickly come to represent more than 30% of Apple's sales. Meanwhile, nearly all the growth in search is expected to come from mobile devices, which Piper Jaffray predicts will account for 23.5% of all searches in 2016, up from less than 5% today. That sets the stage for a new main event in the tech sector. "This rivalry is going to accelerate innovation," says Andreas Bechtolsheim, a co-founder of Sun Microsystems and an early investor in Google. "Apple goes pretty fast, but having someone chasing you always makes you go faster. This is going to be good for consumers."

Still, in a battle over the future of computing, friendship will almost surely be a casualty of progress. "You can just feel the tension rising," says Piper Jaffray analyst Gene Munster. "Until the Nexus One, the competition was at arm's length. But the iPhone is Apple's darling. Now it's personal." | BW |

Business Exchange

Read, save, and add content on BW's Web 2.0 topic network

Did Google Do the Right Thing in China?
Google's decision to stop censoring search results in China sparked strong reactions. The Web site ChinaSmack, which translates Chinese Internet postings, collected many from the country's native speakers. "I applaud Google for … taking a stand on some very important issues," wrote one person. "This isn't Google making a moral stand," wrote another. "Google isn't making any money in China."

To find all the reactions, go to **bx.businessweek.com/google/reference**

www.storemags.com & www.fantamag.com

GOOGLE AND CHINA: A WIN FOR LIBERTY—AND STRATEGY

"Don't be evil" is a good motto. But then again, so is "don't stay with a loser"

By Bruce Einhorn

Isaac Mao saw this coming. In early 2007, a year after Google launched a China-based version of its search engine that adhered to Beijing's strict censorship rules, the prominent Chinese blogger posted an open letter to founders Larry Page and Sergey Brin. Mao described the frustration he and other Chinese Google fans felt as a company with the informal motto "Don't be evil" obeyed policies forbidding access to sites deemed taboo by China's government. Google's self-censorship "hurts those loyal users a lot," wrote Mao, who said it was "high time to change [Google policy] back to the right track."

Now the 37-year-old Mao seems to be getting his wish. After Google's Jan. 12 announcement that it would stop censoring search results on Google.cn—in response to what the company called "highly sophisticated" hacking from China of its computer systems and the infiltration of Gmail accounts of human-rights activists—Internet users in China had new hope they might gain access to information on the 1989 Tiananmen Square crackdown, the Dalai Lama, and other banned topics. The company says it will quit China if it can't run a permanently unfiltered search engine. It's hard, though, to imagine the Chinese giving Google, or anyone else, that kind of autonomy.

An exit from the mainland would uphold the right of free expression and acquit Google in the eyes of those who protested its initial complicity with Chinese restrictions. "It's a smart move," says Mao. But before heaping too much praise on Page and Brin, it's worth noting that a pullout would also end a bruising commercial battle. In the U.S. Google has over 60% of the search market. In China its share of search profits is 35.6%, a distant No. 2 to local champion Baidu's 58.4%, according to China data tracker Analysys International. No wonder, says David Wolf, CEO of Beijing-based advisory firm Wolf Group Asia, "Google appears to be more interested in winning hearts and minds than in sustaining its business in China."

China, which has more than 330 million Web users, has not been kind to American Web giants. Instead of replicating their U.S. success, eBay, Yahoo!, and Microsoft portal MSN found they couldn't go it alone against such domestic rivals as Baidu, e-commerce leader Alibaba's Taobao, and instant messaging power Tencent. Even after U.S. players teamed up with local partners, they still trailed.

Google struggled from the get-go. Despite its submission to censorship, its YouTube business was regularly blocked, and censors still occasionally restricted access to the entire search engine, not just results to offending queries. After Google announced that it would alert Chinese users every time it provided them with a censored result, the government-run media attacked the company for allegedly operating without a license. Chinese Net users even mocked Google's Chinese name, a transliteration of the word Google that was rendered inelegantly as "Valley Song." Google also had to wage a bitter court battle in 2005 before winning permission to hire a brilliant Microsoft executive, Kai-Fu Lee, to head its China business. Lee quit in September.

Google says financial considerations have nothing to do with its challenge to the Beijing censors. Outsiders disagree. "Google is in a really tough spot," says Bill Bishop, a Beijing-based angel investor in Chinese startups. "There is no long-term potential." By citing the hacking and censorship issues as reasons for leaving, Google can end its agony and "get this incredible lift in brand equity," he says. Google won't lose much financially: Its Chinese business was on target for 2010 sales of $600 million, according to JPMorgan Chase. That's a fraction of Google's estimated overall sales this year of $26 billion.



Google's Beijing headquarters after it announced it may leave China

VINCENT THIAN/AP PHOTO

The irony is that the main Google site, Google.com, is popular with China's English-speaking elite, who find local search engines insufficiently global. Sounds like the makings of a good business. Such logic doesn't always work in China.
—With Tom Giles in San Francisco and Douglas MacMillan in New York

www.storemags.com & www.fantamag.com



www.storemags.com & www.fantamag.com



KRAFT'S SUGAR RUSH

CEO Irene Rosenfeld's pursuit of Cadbury is testing her considerable powers of persuasion—and could define her career

By Susan Berfield and Michael Arndt

Illustration by Anita Kunz

Irene Rosenfeld hasn't been around Kraft Foods' suburban Chicago headquarters much lately. The door to her wood-paneled office is kept closed. Her desk is bare. Rosenfeld has grabbed her leather folders of meticulously compiled research and is traveling to London and around the U.S. in Kraft's Gulfstream jet. These trips weren't supposed to be urgent or secretive, but they've become both as Rosenfeld scrambles to reassure shareholders that her surprising $17 billion hostile bid to buy British candymaker Cadbury will be good for them.

Rosenfeld, 56, has led Kraft since 2006 and has worked there for almost her entire professional life. She can be pretty persuasive. Early on she told her bosses that commercials for Kool-Aid should be aimed at kids (not mothers), and that Jell-O could be made modern with new flavors. In the late 1990s, she turned around Kraft's business in Canada; troubled as it was when she arrived, the first thing she had to do was show skeptical colleagues that an American could understand Canadian consumers. As chief executive, she has won most employees' cooperation for a wrenching reorganization. "When she is trying to persuade you of something, she will be relentless in coming back with facts and showing you she has the support of other people," says John Bowlin, who ran Kraft North America in the mid-1990s. "She will be totally emotionally and intellectually committed to her idea."

Now Rosenfeld must summon all of her powers as she takes on her biggest marketing challenge yet: selling the Cadbury deal to shareholders. Her task is all the more difficult because she has alienated her biggest shareholder and one of the world's most influential investors, Warren Buffett.

So confident was Rosenfeld of the deal's potential to transform Kraft into a global juggernaut that she told investors on Dec. 18 she planned to issue new stock to help pay for the purchase. The subtext: She might be willing to raise her original $17 billion bid, which Cadbury management had complained was too low. But Buffett didn't like the idea of paying more. On Jan. 5 he issued a press release warning Rosenfeld not to sell more stock or increase her price, even if other bidders emerge. It was an unusually public smackdown for an investor used to operating behind closed doors. Rosenfeld and Buffett declined to comment.

Now, to save the deal, Rosenfeld is traveling the world to placate two groups of shareholders: Kraft's, who are increasingly worried that she'll pay too much, and Cadbury's, who are being told she's offering too little. She has until Jan. 19 to make her final offer, and until Feb. 2 to persuade them all. Win or lose, says former Kraft CEO Robert S. Morrison, the Cadbury affair "will be defining for her career."

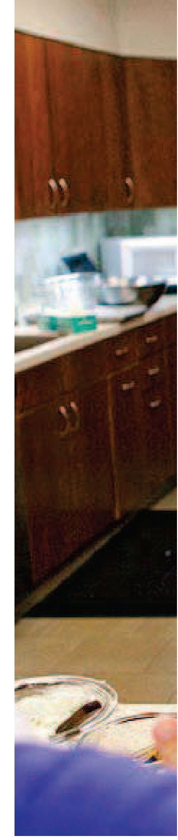
Kraft is the world's No. 2 food company after Nestlé, selling $42 billion worth of Kraft Macaroni & Cheese, Oreos, Oscar Mayer cold cuts, and hundreds of other brands each year. It is the product of two decades of dealmaking. Philip Morris International, seeking to broaden its reach beyond cigarettes, bought General Foods (which had among its brands Jell-O, Minute Rice, and Kool-Aid) in 1985, succeeded in a hostile takeover of Kraft in 1988, merged the two companies by 1995, and five years later bought Nabisco.

MIDNIGHT BRAINSTORMING

During the 1980s, General Foods, which was based in Westchester County, N.Y., had a reputation as an intellectually challenging workplace where debate was encouraged. It was here, in 1981, that Rosenfeld got her start in market research. She had spent most of the previous decade at Cornell University completing an undergraduate degree in psychology, an MBA, and a PhD in marketing and statistics. Her thesis adviser, Vithala R. Rao, recalls that even though she was working and pregnant she was determined to finish her dissertation on how consumers make decisions about purchases. "She knew a PhD would give her an edge in the business world," says Rao. "And her husband was getting one. They were a little competitive."

When Rosenfeld presented her bosses at General Foods with research showing that Kool-Aid should be marketed directly to kids, the pitch won her a job working on the brand full-time. It was an unexpected turn for a researcher. After a presentation at one of her first meetings with Grey Advertising, Rosenfeld was so excited that she applauded. Back then, junior employees were expected to stay silent. "We were all so shocked and amused by her reaction," says Carol Herman, who worked at Grey and remains a close friend of Rosenfeld's.

www.storemags.com & www.fantamag.com



As Rosenfeld came up through the ranks at General Foods and Kraft—eventually overseeing the Nabisco integration and serving as president of Kraft North America—she developed a reputation as a tough and insistent boss. She would call people with ideas, however big or small, late into the night. Conversations about kids turned into discussions about Kraft products. "I can't tell you how many midnight talks we had about Minute Rice and Stove Top stuffing," says Herman, who worked on various accounts for Kraft through the 1990s. Says James M. Kilts, a former Kraft president who later ran Gillette: "Irene didn't need a lot of advice. That's why I liked her. She was giving me the right answers." Yet her intensity and self-confidence didn't always endear her to colleagues. One former executive recalls a time when Rosenfeld provided helpful insight into a business she had once managed. When the executive offered to return the favor, Rosenfeld took a pass.

In 2001, Rosenfeld suffered her first big professional setback when a contemporary, Betsy D. Holden, was appointed co-chief executive alongside Roger Deromedi. Rosenfeld stayed on almost two more years, then left to join Frito-Lay, a Kraft rival more global in its outlook and more local in its decision-making. "Irene thought about the marketing agenda and innovation much more aggressively" than the company was used to, says Indra Nooyi, the CEO of PepsiCo (page 50), which owns Frito-Lay. "She was fearless in what she did."

"REWIRE FOR GROWTH"

Rosenfeld gave every impression that she was committed to Frito-Lay for the long term. But when Kraft asked her to return as CEO in June 2006, she jumped. The dual leader experiment had failed; Kraft was faltering amid high commodity prices, increasing competition from private labels, and a misplaced focus on cost-cutting. She told Kraft's nearly 100,000 employees that the company had lost its heart and soul and needed to "rewire for growth." In a speech at Cornell in 2007, Rosenfeld described her return to Kraft. "The staff was tired, raw, disillusioned," she told the audience. "My slogan was, 'let's get growing.' It's not a warm and fuzzy strategy." She replaced half of her executive team and half of those in the next two levels down. She reorganized the structure of the company, changed how people receive their bonuses, and told everyone "to stop apologizing for our categories and make them more relevant." She concluded her talk: "Sometimes I lie awake thinking, 'Should we?' And then I think, 'How can we not?' "

Rosenfeld wasn't alone in wanting change—activist investor Nelson Peltz was demanding it. She learned that engagement and conciliation were the best ways to handle powerful dissenters. When Peltz pushed her to sell some brands, she did, unloading Veryfine fruit juice and Post cereals. And when she asked him not to purchase more than 10% of the company, he agreed.

Peltz was also a big investor in Cadbury Schweppes, and he persuaded the British food giant to sell its soft drink division in 2008 and become purely a candy company. That would set the stage for Rosenfeld's eventual hostile takeover bid and provide Cadbury its philosophical defense: It didn't want to lose focus on its core business by becoming part of a conglomerate.

As the Great Recession took hold, Kraft should have thrived. But even though consumers ate at home more often and ingredient prices fell, the company was forced to cut prices to compete with private label products. For 2009, Rosenfeld's goal was sales growth of 4% and profit growth of at least 7%. Instead, revenue fell 6% through the first three quarters of 2009, with net income down 14.6% over the same period. Kraft stock, which went public at $31 a share in 2001, fell as low as $21 last March. (It has been hovering at about $29 this year.) The company introduced items such as Bagel-fuls, bagels stuffed with Philadelphia cream cheese. The products did well, but not well enough to have a major impact. Rosenfeld also devoted considerable resources to creating premium toppings for Kraft's DiGiorno frozen pizza, and frequently pointed to the brand's success.

With the recession abating, Rosenfeld started thinking of ways to transform the company. "She wanted to capture the imagination of the world about what Kraft could be," says Shelly Lazarus, chairman of ad agency Ogilvy & Mather Worldwide, which works with Kraft. Rosenfeld began studying the possibility of buying Cadbury, which sells Trident gum and chocolate in 60 countries and has sales of about $8 billion. It's a fast-growing global business with high profit margins.

Eventually she fixed on a price, and in early August decided to approach Cadbury Chairman Roger Carr with an offer. On Aug. 28 she met with Carr in London to lay out her plan. "She was brisk, efficient, delivered her proposal and left quite quickly," says Carr. The two haven't spoken since, he says.

(TOP) TODD ROSENBERG; (CANDY) DAVID RUDES/BW

THE CHOCOLATE WARS









	Mars	Nestlé	Kraft	Ferrero
GLOBAL MARKET SHARE	14.6%	12.6%	8.3%	7.3%
BEST-SELLING CANDIES	M&Ms, Snickers, Milky Way	Nestlé Crunch, Butterfinger	Milka	Ferrero Rocher
ETC.	Snickers was named after the Mars family's favorite horse in 1930	Just bought Kraft's frozen pizza business and said it wouldn't bid for Cadbury	Milka's mascot since 1901 has been a purple cow	The Italian company is known for its chocolate-hazelnut spread Nutella

Data: Euromonitor 2008; companies

www.storemags.com & www.fantamag.com



Rosenfeld (left) meets a parenting blogger at the Kraft Kitchens in Illinois

They have, however, exchanged a few letters. In the first, which Carr sent to Rosenfeld the next week, he called the offer "derisory." Then on Labor Day, Rosenfeld announced Kraft's bid in a news release on the corporate Web site, hoping to win over shareholders directly. She spoke to several British newspapers about her admiration for Cadbury and the great promise of a merger. In a video interview posted on the Kraft site, she expressed her enthusiasm for Cadbury's products in a way only a marketer could appreciate: "I am a heavy, heavy user of Trident gum and, on a seasonal basis, I love those Cadbury eggs." But after receiving no encouragement from the candymaker, Rosenfeld launched a hostile bid on Nov. 9. "We believe that our proposal offers the best immediate and long-term value for Cadbury's shareholders and for the company itself compared with any other option currently available, including Cadbury remaining independent," she wrote in the formal offer.

Meanwhile, Rosenfeld was juggling another deal that would determine how much Kraft could spend for Cadbury. In early 2009, Nestlé made a surprise offer to buy DiGiorno and the rest of Kraft's pizza business. Rosenfeld concluded that selling the unit made sense: Frozen pizza wouldn't do well outside of North America, and within the company it was an isolated brand. Next she had to persuade the board. "It was a difficult decision. But once we got our heads around the strategic and financial rationale for the deal, it became clear," says Perry Yeatman, a Kraft spokeswoman. Closing the sale proved difficult; it wasn't until Jan. 5 that Kraft announced it would sell the pizza business to Nestlé for $3.7 billion. Some investors thought the price was too low. But the deal would give Rosenfeld the cash she'd need to pursue Cadbury. And there was another benefit: Nestlé, Kraft's main rival for Cadbury, said it wouldn't bid.

Whatever sense of relief Rosenfeld might have felt didn't last long. On the same day, Buffett went public with his concerns, calling Rosenfeld's proposal to issue more shares a "blank check." He noted that while the company had bought back shares at a price of $33 a piece in 2007, it would be selling the new shares for the Cadbury transaction for far less. He did say, though, that he would support an offer that "does not destroy value for Kraft shareholders." Other investors share Buffett's skepticism. "What is she wasting our money for?" asks John Kornitzer, founder of Kornitzer Capital Management in Shawnee Mission, Kan. "To chase after these guys is ridiculous." Alice Schroeder, a former Wall Street analyst and author of a biography of Buffett who also writes a column for Bloomberg News, says even if Rosenfeld had consulted with Buffett it might serve his purposes to take a public stand. He can take credit for reining her in and defending shareholders. "No matter how this turns out, Warren looks great," she says.

Rosenfeld, however, is under attack from all sides. On Jan. 12, Carr released a stinging "defense document" on Cadbury's Web site, saying "the bid is even more unattractive today than it was when Kraft made its formal offer." Kraft called the argument "underwhelming." Carr responds: "I think the clarity with which we reviewed Kraft's own record must have been disturbing for them and illuminating for our shareholders."

Kraft shareholders will vote on whether to issue more stock on Feb. 1; the next day Cadbury stockholders will vote on the offer. Rosenfeld spent Jan. 12 with Cadbury investors in the U.S. before jetting to London to talk with Cadbury shareholders there. Some refused her visit, says Carr. While Rosenfeld remains determined to make Kraft bigger and more global, finding a price for Cadbury that works for everyone might be impossible. "Rosenfeld has made it clear that she's disciplined, that she won't overpay," says Donald Yacktman, president of Yacktman Asset Management, a longtime investor. "I guess we'll find out how much she really means what she says." | BW |





Cadbury	Hershey
6.9%	6.7%
Cadbury Creme Egg	Hershey's, Hershey's Kisses
Cadbury became solely a confectioner after spinning off its beverage business in 2008	America's milk chocolate pioneer has been considering making an offer for Cadbury

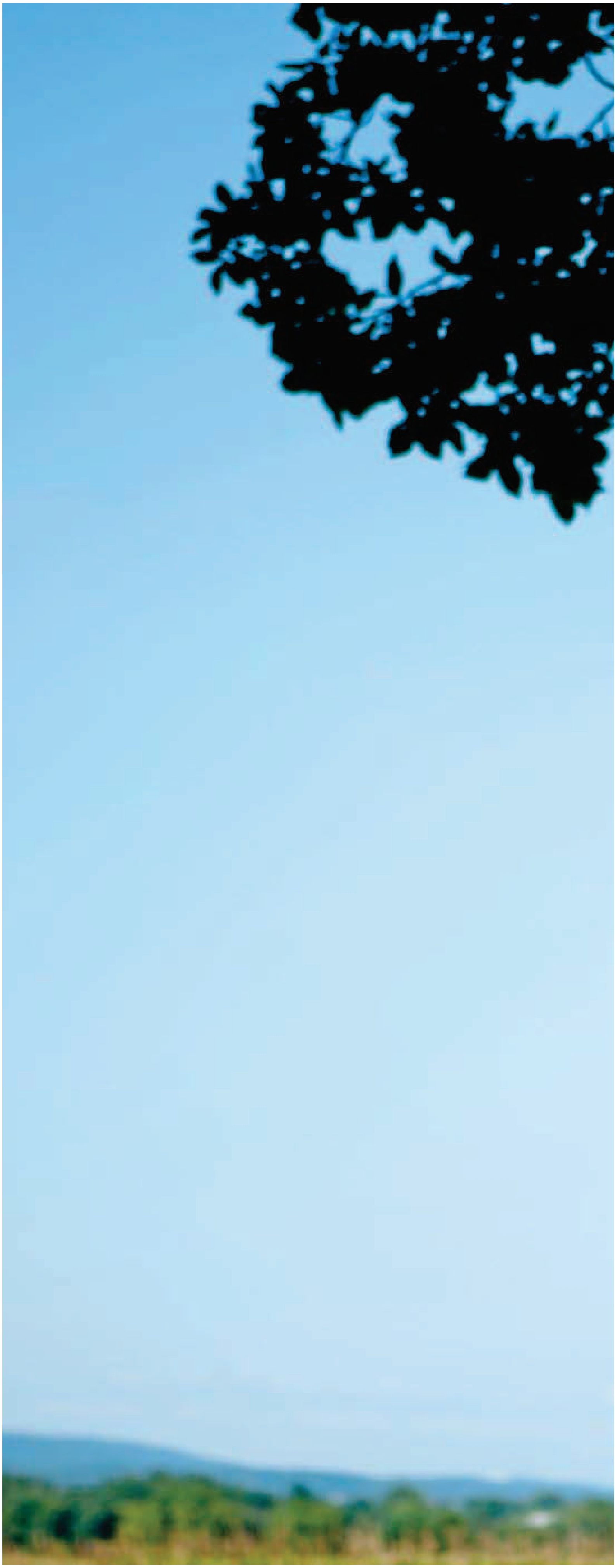
www.storemags.com & www.fantamag.com

THE HUNT FOR AN AUTISM DRUG

By Ellen Gibson

Photograph by Jeff Hutchens

Armed with fresh medical insights, drug companies are redoubling their efforts to address the disease's complex causes



The Weakley family lives in Dover, Pa., about 30 miles south of Harrisburg. Their two-story house sits on a mostly treeless tract of land, across the road from a big white barn. Seated at the dining table, Beverly Morgart-Weakley is describing the recent changes she's seen in her 21-year-old daughter Jennifer. Once unable to form words, "she keeps saying 'mama,' and she's starting to say the beginnings of other words. You'll hear something that almost sounds like a sentence and you can figure out what she's trying to tell you."

Every parent looks forward to these developmental milestones, but Beverly has been waiting two decades. In the early 1990s, Jennifer was diagnosed with autism, and her early childhood was dominated by doctor's visits. Things got worse in her teens. The girl would sometimes bite her own arms in paroxysms of frustration. Many times she grabbed her mother or her younger sister by the neck and squeezed hard. Even the family's collie was bitten.

Beverly was skeptical of medications, but she needed a way to quell her daughter's increasingly violent outbursts. Doctors tried the antipsychotic drug Risperdal, but Jennifer gained

Beverly Morgart-Weakley's daughter Jennifer has improved on the drug Namenda

REPORTAGE BY GETTY IMAGES

www.storemags.com & www.fantamag.com



www.storemags.com & www.fantamag.com

weight and grew sluggish. Then they turned to Zyprexa, a schizophrenia medication, but the symptoms persisted. Over the past year the family has had a modest breakthrough with Namenda, an Alzheimer's drug from Forest Laboratories. Jen's aggression has subsided and her communication skills have improved. "She is still far from normal," says Beverly, looking on as her daughter repeatedly opens and closes the refrigerator, then settles on the floor in the den and methodically removes every item from a filing cabinet. "But she's made progress, and that in itself is a miracle."

EVOLVING SCIENCE

Encouraged by even partial success stories like the Weakleys', the drug industry is gearing up for an assault on autism. The timing makes good sense for both scientific and economic reasons. Powerful genetic tools and brain-imaging techniques have given researchers fresh insights about the disorder, often described as a "spectrum" because symptoms vary greatly in nature and severity. In the past year scientists at several small biotech companies have voiced excitement over new drugs in early-stage clinical trials. Last year, industry giant Pfizer formed a 14-person autism research group at its Groton (Conn.) laboratories. "The science has evolved to the point where we can now start investing in potential pathways and targets," says Anabella Villalobos, Pfizer's vice-president for neuroscience chemistry.

From a drug-industry standpoint, the demographics of the disease are also compelling. Diagnoses among children jumped 57% from 2002 to 2006, according to the Centers for Disease Control & Prevention in Atlanta. Roughly 1 in 110 8-year-olds in the U.S. is on the autism spectrum. Just as interesting to drugmakers is the fast-growing population of adult autistics who can't be helped by the kind of intensive behavioral therapy that sometimes works on children, because their brains lack the same plasticity. One decade from now there will be seven times as many autistics entering the adult-services sector as there are today. The disorder already costs the U.S. about $35 billion per year for special education, medical care, and assisted living. If the drug industry can devise better treatments, families and society will find a way to pay.

At the federal level, autism is already a priority. Among pediatric disorders, only diabetes, AIDS, and asthma draw more research funding from the National Institutes of Health. Last year, President Barack Obama allocated $60 million of stimulus funds to the autism research pool and earmarked $1 billion for studies extending through 2018. While many medical authorities play down the idea of an autism epidemic, noting that better detection and changes in diagnostic criteria account for part of the rise, most experts believe cases are increasing.



Researchers often express awe at autism's complexity. "Early on we felt that if we could collect large enough samples of families with multiple affected individuals, we would find the autism gene," says Dr. Eric Hollander, a psychiatrist and former director of the Seaver Autism Center for Research & Treatment in New York. "As the sample size got bigger, there were more genes popping up that had minor effects."

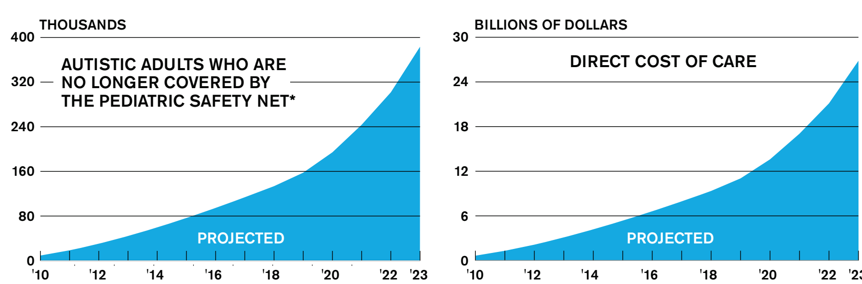
Many autism experts are now looking to epigenetics for a possible explanation. This is the branch of genetics that looks at how the environment influences gene expression. Last year, researchers at the University of California Davis's MIND Institute concluded that the state's sevenfold increase in autism cases since 1990 is most likely linked to environmental exposure—to pesticides, viruses, chemicals in household products, or some other agent. One reason they think so: there are cases in which one identical twin is autistic and the other is not; the two have identical genes, so environmental factors must contribute.

Considering how little is known about the underlying biology, it's not surprising the Food & Drug Administration has yet to approve a single medication to treat the core conditions of the disorder. Yet drugmakers are racking up nearly $3.5 billion in annual sales for treatments aimed at managing secondary symptoms—everything from antidepressants for anxiety to anticonvulsants for seizures.

As autistic people grow up, their doctors often add to the drug regimen, meaning an autistic adult may be on three or four different drugs at once, with no solid data on their effectiveness or how they may interact. A 2007 study found that 70% of autistics ages 8 and up received a psychoactive medication in a given year. "The word 'experimentation' sounds scary," says Bryan H. King, director of psychiatry

COMING OF AGE

A new calculation, starting in 2010, shows the rapid, cumulative increase in the population of autistic adults in the U.S. and the climbing cost of care



*Doesn't include high-functioning adults on autism spectrum
Data: SAGE Crossing Foundation

PHOTOGRAPH BY JEFF HUTCHENS/REPORTAGE BY GETTY IMAGES; CHART BY LAUREL DAUNIS-ALLEN/BW

www.storemags.com & www.fantamag.com



Weakley hopes for a drug that will "unlock" her daughter's potential

at the Seattle Children's Hospital. "People aren't randomly picking drugs off the shelf and saying, 'Let's try this.' But it starts to look like that when you take two steps back."

As a research target, autism has suffered from companies' reluctance to run large placebo-controlled trials. When such studies were done, the results were mostly disappointing. In June, for example, a large trial of Forest Labs' depression drug Celexa showed no benefit over a placebo. Up to that point, Celexa had been a go-to drug. But greater efforts by large drugmakers change the picture: "Companies are finally starting to take an interest in autism, which is great to see," says King.

MISWIRED BRAINS?

While blockbusters may still be far off, researchers are laying foundations for discovery. The new research team at Pfizer, for example, is focusing on genes that may affect synapses in the brain. These are the spaces where two nerve endings meet—a tiny gap neurochemicals must cross in order to transmit information. Many researchers are now framing autism in terms of information processing, says Larry Fitzgerald, a scientist who helped found Pfizer's autism team before departing the company in September. Brain-scan data, for example, suggest autistics may process spoken language more slowly than "neuro-typicals," meaning non-autistics. One theory holds that the brains of autistics are miswired, with too many local neural connections and too little long-distance connectivity. The latter might make it difficult to integrate new information, causing characteristic social impairment, posits Clarence Schutt, a Princeton University chemistry professor who co-founded the National Alliance for Autism Research. On the other hand, enhanced local networks could explain why some autistics are exquisitely tuned to sensory input, and may explain the "savant" capabilities—musical or mathematical genius, for instance—that about 10% of autistic people display.

While Pfizer plumbs the basic biology, tiny Seaside Therapeutics in Cambridge, Mass., is going after a specific target. The company has zeroed in on a rare brain disorder called Fragile X, caused by a mutation on the X chromosome and known to cause a hereditary form of autism. Founded in 2005 by former Massachusetts Institute of Technology neuroscientist Mark F. Bear, Seaside has two drug candidates in clinical trials. Like Jennifer Weakley's drug, Namenda, these compounds zero in on the brain's glutamate system, involved in learning and memory.

"What you need is a company to be successful—to show that the FDA will approve you, and that you can make money—and everybody will jump in," says Seaside CEO Dr. Randy Carpenter. "If [a drug] shows a benefit, we can charge a premium."

Some experimental treatments focus on the social-bonding aspects of the disorder. Oxytocin, which is given to pregnant women to induce labor under the brand name Pitocin, has earned the nickname the "love chemical," because studies in healthy adults have shown that sniffing it results in the formation of strong bonds of trust. Studying the effects of the drug on patients with Asperger's, a syndrome marked by social awkwardness that is on the less severe end of the autism spectrum, psychiatrist Hollander found a reduction in repetitive behaviors and an improved ability to recognize the emotional tone of sentences. Other drugs target the brain's interaction with organs that aren't usually associated with autism, including those of the gastrointestinal tract and the immune system.

One of the most promising treatments in this category is a drug called CM-AT made by a startup called Curemark. Dr. Joan Fallon, the company's founder and CEO, observed that many autistics show a strong preference for foods high in carbohydrates and low in protein. A diagnostic test revealed that some autistic children lack enzymes that digest protein. As a result, these children produce fewer of the essential amino acids that are the building blocks for brain development and neuroreception. Fallon believes this deficiency is linked to the most severe symptoms of autism, and she says an early observational study of CM-AT, an orally ingested powder that delivers protein-digesting protease, showed "significant improvements." Curemark is enrolling patients in phase III clinical trials at 10 to 12 sites—the largest autism trial to date.

IF JUST ONE DRUG CAN GET APPROVED BY THE FDA AND MAKE MONEY, "EVERYBODY WILL JUMP IN," SAYS ONE BIOTECH EXECUTIVE

Beverly Weakley is counting on Namenda—or some yet-to-be-formulated treatment—to "unlock" Jennifer's potential. She describes how one day, many years ago, she heard Jennifer call out from another room "Mommy, I need you." It was as though a window to her daughter had opened up. She raced to her daughter's side, but by the time she got there, Jen was "gone." Since then, the long silence has been almost unbearable, but Beverly has learned not to dwell on setbacks. She keeps hoping, she says, that the window will reopen. | BW |

www.storemags.com & www.fantamag.com

THE TRANSFORMER:

WHY VW IS THE CAR GIANT TO WATCH

By David Welch

Illustration by Eddie Guy



Volkswagen is bent on displacing Toyota as the world's biggest car company—and it just may succeed

When Volkswagen CEO Martin Winterkorn said two years ago that he was determined to zoom past Toyota to become the world's biggest automaker, the notion seemed laughable. At the time, the German automaker sold 3 million fewer vehicles than Toyota, was losing ground in the U.S., and had a reputation for iffy quality. Toyota, then set to pass General Motors as the best-selling carmaker on the planet, seemed unassailable.

Today Toyota is vulnerable, and Winterkorn's ambitions seem a lot less outlandish. In November, for the first time, VW built more cars than its Japanese rival. Toyota still sells more each year, but VW has closed the gap to less than 1.5 million cars. Quality continues to be an issue for VW in the U.S., but Toyota is the one suffering negative headlines after a series of embarrassing recalls. Toyota's CEO—in an act of extreme self-flagellation—has even said his company's best days may be behind it.

Winterkorn sees an historic opportunity. And with the backing of his formidable boss and mentor, VW Chairman Ferdinand Piëch, he's seizing it. By 2018, Winterkorn vows, VW will pass Toyota. "VW saw a chink in Toyota's armor and realized they could act on their ambitions," says Stephen Pope, who follows the industry for Cantor Fitzgerald in London. "They

www.storemags.com & www.fantamag.com



www.storemags.com & www.fantamag.com

went for it straightaway."

All over the globe, Winterkorn, 62, is punching the accelerator. VW has agreed to buy a 20% stake in Suzuki Motors to gear up for an assault on the rapidly growing markets of Southeast Asia and India. Winterkorn is going after BMW and Mercedes, committing $11 billion over the next three years to Audi, VW's luxury brand. Peter Schwarzenbauer, a board member who oversees Audi's sales and marketing, says the brand plans 10 new models, including the A1, the world's first "premium subcompact."



CEO Winterkorn greets the press at VW's Wolfsburg headquarters last year

AIMING DOWNMARKET

Winterkorn's most ambitious plans are in the U.S., where he aims to double sales by 2012. It was only five years ago that VW tried and failed to move upmarket in the U.S. Remember the Phaeton, the VW with a sticker price of $85,000? Now Winterkorn is reversing course. He's betting that Volkswagen can steal customers from Toyota, Honda, Ford, and others by selling Americans on German engineering and style at affordable prices. This year, VW will introduce a compact priced to compete with cars like the $16,000 Toyota Corolla. "We have to bring the masses to VW," says Mark Barnes, VW's U.S. chief operating officer.

Beating Toyota won't be easy. For starters, VW sells fewer vehicles in the U.S. than Subaru or Kia and still has a reputation for making unreliable, overpriced cars. In Southeast Asia—a Toyota stronghold—the VW brand is practically unknown. Ditto for India. Winterkorn's plan to double Audi's sales in the U.S. by 2018, meanwhile, isn't exactly scaring BMW. "They have been saying that for years," says Jim O'Donnell, president of BMW of North America.

Still, VW is a formidable competitor; it earned $975 million in the first three quarters of 2009, despite the global collapse of car sales, and it has $33.3 billion in cash. "We want to make [VW] the economic, ecological, and technological leader by 2018," Winterkorn wrote in an e-mail. "Our goal is not just about size—we are aiming for quality-driven growth."

'VW SAW A CHINK IN TOYOTA'S ARMOR AND REALIZED THEY COULD ACT ON THEIR AMBITIONS. THEY WENT FOR IT STRAIGHTAWAY'

Piëch has long wanted to move beyond VW's bases in Europe, China, and Brazil. In the 1990s, as Audi chairman and later VW CEO, Piëch acquired lower-end brands, including Spain's SEAT and the Czech Republic's Skoda. Later he added ritzy names like Bentley, Lamborghini, and Bugatti. "He used to privately talk about selling a car for every purse and purpose like Alfred Sloan did at GM," says Garel Rhys, president of the Center for Auto Industry Studies at Cardiff University in Wales.

By the end of 2006 it was clear that VW's move upmarket wasn't working, and in January 2007 Piëch installed Winterkorn as CEO. Before his elevation, Winterkorn ran Audi, where he boosted quality and supercharged growth with new models that rivaled BMW's cars. Winterkorn rewarded employees for speaking their minds and bringing ideas to his attention.

In the summer of 2007, Winterkorn and the board met to brainstorm ways to become the world's biggest automaker, says VW's U.S. chief, Stefan Jacoby. High on the agenda was fixing VW's America problem. That year, VW expected to sell 200,000 cars in the U.S., a 40% drop from 2000 and a third of what VW sold in 1970 when the Bug and Bus were Hippie icons. Jacoby says executives at the meeting saw three choices: They could continue to lose buckets of money selling cars that were too small and too expensive; they could wave the white flag; or they could go on the offensive. They chose Door No. 3.

Jacoby says he persuaded the board to build VW's first U.S plant. He recalls arguing that doing so would help VW overcome resistance in the American heartland to imported vehicles. If VW built the plant, Jacoby recalls saying, he would sell 150,000 cars from that factory alone each year. The board approved the plan and allocated $1 billion for the facility, which is scheduled to open next year in Chattanooga, Tenn. VW's decision to build cars in the U.S. has not gone unnoticed by its

(TOP) JOERN POLLEX/GETTY IMAGES

www.storemags.com & www.fantamag.com



main rival. “The fact that they are producing in the U.S. gives them a leg up,” says Donald V. Esmond, senior vice-president for automotive operations at Toyota Motor Sales USA. “But we’ll just keep focusing on our customers.”

Jacoby’s most pressing challenge is devising a roomy family sedan at a price Americans will pay. Today’s Passat, despite being smaller than most mid-size sedans, sells for $28,000, or $7,000 more than a Toyota Camry. That’s largely why VW sold only 11,000 Passats in the U.S. last year, compared with some 350,000 Camrys. VW plans to stretch the Passat’s successor four inches, add three inches of legroom, and sell it for a starting price of $20,000. Timothy Ellis, VW’s U.S. marketing chief, says he expects to move more than 135,000 mid-size sedans a year starting in 2011. James N. Hall, principal of the auto consulting firm 2953 Analytics, is skeptical. Typically, Hall says, it takes two generations for a new mid-size sedan to get traction in the U.S. “The first-generation car is going to have to hit it out of the park,” he says.

Industry analysts say Winterkorn’s mass market approach could work in the U.S. VW will be the only company offering affordable European cars. BMW and Mercedes sell German engineering, but their cheapest models start at $30,000.

According to a source briefed on VW’s plans for the U.S., the company plans to expand its lineup from 10 cars today to 14 in five years. VW will have new compact and mid-sized sedans priced for the American market, plus a small SUV. VW also may introduce its Polo compact—now available in Europe, China, and other markets—to the U.S.

VW will have to convince Americans its cars are worth buying. In J.D. Power & Associates’ Initial Quality Study, which ranks cars in the first three months of ownership, VW came in 15th out of 37 last year. The company’s ranking improved from 24th in 2008. But VW still trails Toyota, Honda, and Nissan, as well as the Chevrolet and Ford brands. What’s more, though 78% of Americans know the VW brand, only 2% buy the cars. Most Americans recognize the Beetle and Jetta, says Ellis, but draw a blank on VW’s other six U.S. models. “Volkswagen has a bigger brand than it deserves,” he says. “But we have a low sense of awareness for our products.”



Jacoby, VW’s U.S. chief, says he persuaded the board to build a U.S. factory

Turning around those perceptions will take a sustained marketing push. VW’s new American commercials will debut during the Super Bowl on Feb. 7 in a campaign called “Punch Dub,” (as in Vee Dub). It’s a reference to a game kids used to play back in the original Beetle’s heyday: The first kid to see a Beetle would yell, “punch Bug,” and slug their friend. In the ads, people will say, “punch Dub,” when a Jetta, Passat, or any other Volkswagen model drives by. The idea: Show millions of Americans that VW sells something besides the Beetle.

If VW is playing catch-up in the U.S., it is many laps behind its rivals in India and Southeast Asia. Indians now buy about 2 million cars a year; Southeast Asians about 1 million. VW is lucky to sell 20,000 cars a year in each region. It will have to steal customers from Honda and Toyota, which have dominated



VW recently unveiled its New Concept Coupe

(RIGHT) STEPHEN VOSS; (BOTTOM) REBECCA COOK/REUTERS

www.storemags.com & www.fantamag.com

Southeast Asia for many years. That's where Suzuki comes in. By buying a stake in the Japanese company, VW gets access to Suzuki's small-car technology. Suzuki's Indian joint venture already does well with its Alto and Swift subcompacts. "India has a massive road-building program," says Cantor Fitzgerald's Pope. "With Suzuki, VW will be able to put out very efficient vehicles."

VW has tapped Wei Ming Soh to oversee its Asia push. A U.S.-educated Singaporean, Soh most recently helped orchestrate a turnaround of VW's operations in China. Soh says VW Group, which includes VW, Audi, and Skoda, will add or freshen 20 models in China by late 2011. His goal is to double VW's Chinese retail network to 1,600 dealers in five years and sell 2 million cars. As part of his Southeast Asia strategy, Soh plans beachheads in Hong Kong and Singapore. Those markets are tiny, selling 30,000 and 100,000 cars a year, respectively. But Soh says Singapore sets trends for Southeast Asia, and Hong Kong is influential in southern China. "My aim is to make these two markets VW states," Soh says.

Winterkorn and Piëch have put in place the pieces of their global strategy. Now that VW's two main rivals, Toyota and GM, are retrenching, they're speeding up their plans. The big question is whether size for size's sake generates real benefits for a car company. Automakers like to get big so they can spread the huge costs of developing new models over mass volumes. Of course, car companies have a tendency to get so big that they become unmanageable. That's what happened to GM. Bolting together various acquisitions also can be problematic. Exhibit A: the unhappy Daimler-Chrysler marriage. Winterkorn and his executives argue that they can retain management control of their sprawling enterprise because VW is more decentralized than many automakers. "The critical factor is that each brand has its independence, a clear positioning, and autonomous management," Winterkorn wrote in his e-mail to *Bloomberg BusinessWeek*.

Eric Noble, president of auto consultant The CarLab, says that Winterkorn's tactical moves make sense. But, he adds, "VW had best be making these acquisitions for reasons other than size alone." Looming over the debate is Toyota. A few years ago, its management decided Toyota needed to be bigger than GM. Look what happened. | BW |

Business Exchange

Read, save, and add content on BW's Web 2.0 topic network

Evolution of an Emblem

A photo- and illustration-packed post on the blog Neatorama traces the evolution of the VW logo from its inception in 1939, when it resembled an iron cross (once the symbol of the German armed forces), to today's more pared-down look. The logos of Audi, Porsche, and a host of other carmakers get similar treatment.

To view the post, go to **http://bx.businessweek.com/volkswagen/reference/**

ONE MAN, ONE CAR, ONE WORLD

Why the Focus is so crucial to Ford—and Mulally

By David Welch

When Alan Mulally left Boeing for Ford Motor three years ago, industry watchers wondered: Does this guy know anything about cars? The question returned on Jan. 11 as Ford unveiled the 2012 Focus at the Detroit auto show. The compact is the first model with Mulally's mitts all over it.

Mulally has won much applause for shunning a government bailout and putting his company on a sustainable road to profitability. Now he needs to prove that his product strategy will work.

At the heart of it is a concept Mulally calls One Ford. The idea is to design one model for multiple markets, rather than having teams of engineers in different regions creating the same basic car. The appeal is obvious: It's a lot cheaper to build one model than several. The most successful so-called world cars are Toyota's Corolla and Honda's Civic and Fit. They have the same guts from Boston to Beijing to Bogota, but often have different styling and features for local tastes. The new four-door or hatchback Focus, by contrast, will be almost exactly the same everywhere.

Ford and its U.S. rivals have tried to sell world cars before—and mostly failed, because the vehicles weren't tailored for individual markets. Mulally needs the Focus to work because the carmaker is planning to release several more models under the One Ford strategy. If he succeeds, he will have proved that a plane guy can teach Detroit a thing or two about cars. | BW |

CONTENDER



FROM BOSTON TO BARCELONA

Designing a car that will appeal to everyone inevitably requires compromises. With the Focus, Ford had to appeal to drivers who expect lots of legroom (Americans) and drivers who demand world-class fuel efficiency (Europeans and Asians).

WINNER



HONDA CIVIC

Honda sells 900,000 Civics worldwide using different engines and body styles in

www.storemags.com & www.fantamag.com



THIS IS NO HONDA CIVIC

While Honda tailors the styling of the Civic to the idiosyncrasies of different markets, Ford has no such luxury with the Focus. It will look the same everywhere, which could hurt its chances.

HOW MUCH DID YOU SAY?

Europeans happily pay big bucks for souped-up compacts. The question is whether Americans and buyers in emerging markets will pay more than $23,000 for a fully loaded Focus.

MORE THAN THE SUM OF ITS PARTS

Ford made sure that it can use parts from the Focus in other models such as the C-Max people mover. The automaker also can use Focus assembly lines to build sister vehicles.

WHO LOVES A HATCHBACK?

The Focus was developed in Europe (Koln, Germany) where hatchbacks are beloved. Americans generally don't like them, but Ford will sell a hatchback version in the U.S. anyway.

MINI ENVY IS CATCHING

So far no compact has matched the price commanded by BMW's Mini. Ford hopes to do so with the Euro stylings of the Focus Titanium Edition, which will sell for about $26,000.



different regions. Along with the Toyota Corolla, it's one of the most successful world cars on the planet.

LOSER



FORD CONTOUR

In the 1990s, Ford spent billions developing the Contour, which was sold in Europe as the nearly identical Mondeo. Americans balked at paying nearly $16,000 for the Contour, which was $3,000 more than the Ford Tempo it replaced. The Contour flopped.

www.storemags.com & www.fantamag.com

52 Amgen's cancer hope
53 IBM, patent king?
54 Quiznos: Back on track
55 Yahoo's spending spree
56 Europe's debt dilemma
57 Greenhouse gas regs
59 Revenge of the hedge fund investors

STRATEGY & COMPETITION

Pepsi Brings in The Health Police

The snack food behemoth has hired a team of idealistic scientists to find alternatives to Doritos

By Nanette Byrnes

In February 2007, when Derek Yach, a former executive director of the World Health Organization and an expert on nutrition, took a new job with PepsiCo, his mother worried that he'd lost his mind. "You are aware they sell soda and chips, and these things cause you to get unhealthy and fat?" she asked him. Yach's former colleagues in public health circles murmured similar concerns.

Yes, he said, he knew what Pepsi made. But he wanted to help guide the $43 billion snack food multinational toward a more balanced product menu. The company describes its current portfolio of "healthy" fare as a $10 billion business—a figure CEO Indra Nooyi says she wants to see jump to $30 billion over the next decade.

The question is, will Yach, now senior vice-president for global health policy, really have the influence his boss has promised? If he does, will Pepsi's strategy prove profitable? Can its growing team of health advocates—who in times past might have seen Pepsi as the enemy—come up with an apple treat that tastes as good as a deep-fried Lay's potato chip?

Over the past two years, Pepsi has hired a dozen physicians and PhDs, many of whom built their reputations at the Mayo Clinic, WHO, and like-minded institutions. Some researched diabetes and heart disease, the sort of ailments that can result in part from eating too much of what Pepsi sells.

Yach and his comrades aren't subversives. The goal, says Mehmood Kahn, Pepsi's first-ever chief scientific officer, is to create healthy options while making the bad stuff less bad. "It's O.K. to have a slice of birthday cake on your birthday," says Kahn, formerly a practicing physician specializing in nutrition who did a stint at the Mayo Clinic. "Would you eat it every day of the week? That's a different question." At Pepsi, he and the other scientists "can say we can actually make an impact on what is available for consumers."



In the lab: Seeking healthy ideas to benefit multiple brands

FLIGHT FROM JUNK FOOD

Khan hunts for benign ingredients that can go into multiple products. Last year, technological improvements to an all-natural zero-calorie sweetener derived from a plant called stevia allowed Pepsi to devise several fast-growing brands, including Trop50, a variation on its Tropicana orange juice that has half the calories of the breakfast standby. Introduced in March, Trop50 has become a $100 million brand. Two Trop50 line extensions are hitting the shelves: Pomegranate Blueberry and Pineapple Mango.

Chief Executive Nooyi says she has no choice but to move in healthier directions. For more than 15 years, consumers have gradually defected from the carbonated soft drinks that once comprised 90% of Pepsi's beverage business. Many switched to bottled water. Meanwhile, the cloud of criticism shadowing Pepsi's largest business, oil- and salt-laden Frito Lay snacks, grew steadily. The company acquired Quaker Oats and other



Mehmood Kahn was hired by CEO Indra Nooyi to develop more nutritious foods

PHOTOGRAPHS BY DAVID YELLEN

www.storemags.com & www.fantamag.com



for an apple or carrot stick," says Bill Pecoriello, CEO of Consumer Edge Research, an independent stock-research firm in Stamford, Conn.

Pepsi built its empire on the manufacture and distribution of instantly recognizable products. It could get a bag of Lay's or a can of Mountain Dew to customers practically anywhere in the world. So far, healthier options have produced only modest hits, including TrueNorth nut snacks and SoBe Lifewater. "We're not building Pepsi again," Nooyi says. She aims to sell a wider variety of products to meet all kinds of consumer demands.

Pepsi's health push includes a controversial plan to sell new products to undernourished people in India and other developing countries. This isn't charity, notes Nooyi, herself a native of India. The goal is to make money. As one of its exploratory ventures, Pepsi is supporting a nonprofit operation in Nigeria that distributes a protein-rich peanut-based paste. Khan says that once the company has figured out what's needed most, Pepsi will shift to for-profit production of nutritionally beneficial processed foods.

One potential hazard of marketing in the developing world is that Pepsi

"SOCIETY, PEOPLE, AND LIFESTYLES HAVE CHANGED. THE R&D NEEDS FOR THIS NEW WORLD ARE ALSO DIFFERENT"

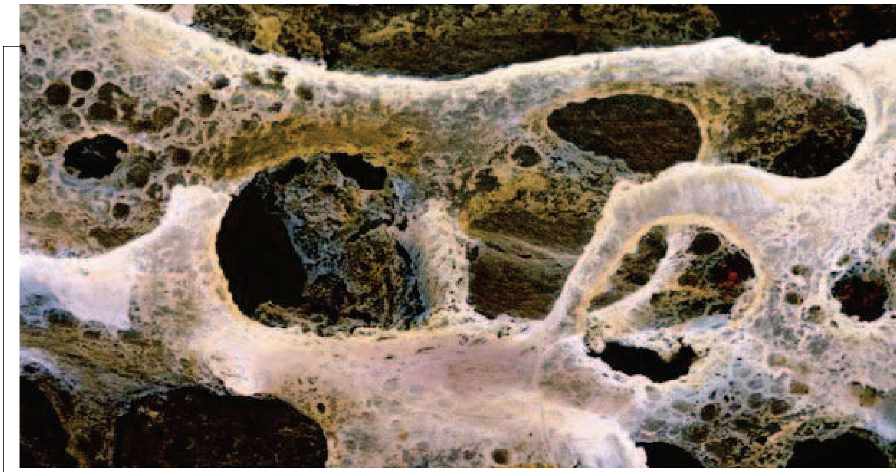
wholesome brands but until recently didn't emphasize research. Nooyi, who took over in 2006, is changing that. She has increased the R&D budget 38% over three years, to $388 million in 2008.

"Society, people, and lifestyles have changed," Nooyi says. "The R&D needs for this new world are also different." Her goal of expanding healthy products to $30 billion in sales would require annual growth in those lines of more than 10%, twice the company's overall historical average.

Coming off a tough 2009, during which once high-flying brands such as Gatorade slipped, Pepsi hasn't convinced Wall Street that Nooyi's plans will pay off. The company trades at a significant discount to its rival, Coca-Cola. While securities analysts say that healthier foods look like a good long-term market, for now, the slowdown in the company's far larger traditional snack-and-soda portfolio cannot be ignored. "The consumer can move to baked chips, or pretzels, or Sun Chips, but they're not yet giving up their chips

could be accused of trading on misfortune and not serving the overall dietary needs of the poor—a criticism that has haunted sellers of infant formula. Kelly D. Brownell, director of the Yale University Rudd Center for Food Policy & Obesity, says Pepsi's developing-nations initiative deserves scrutiny. But Brownell, an industry critic, praises Pepsi for improvements in its mainstream products, such as removing bad fats from its chips. "They're the most progressive player in the industry," he says. | BW |

www.storemags.com & www.fantamag.com



STRATEGY & COMPETITION

Strengthening Bones, Weakening Cancer

Regulators may soon approve an Amgen drug for osteoporosis, but the payoff could be in oncology

By Rob Waters

When Amgen put its new treatment for the bone-thinning disease osteoporosis up for review by the Food & Drug Administration last year, it got an unwelcome rebuke. On Oct. 19 the agency came back with a request for more information on how the company plans to manage infection risks associated with the medicine.

Amgen CEO Kevin Sharer recently told investors the company will submit the required information "very soon." In the meantime, Amgen is pushing the drug, called denosumab, toward a very different goal—keeping cancer from metastasizing into bones in patients with breast and prostate cancer. If it works, analysts say the payoff could help revive the company's fortunes. "The real money is in cancer," says Craig Gordon, an analyst with Cowen & Co. in New York.

Nobody doubts there is immense demand for drugs like this one. Some 65% to 75% of advanced breast and prostate cancer patients eventually suffer bone metastases. The resulting swelling and fractures can cause excruciating pain and may require radiation, chemotherapy, or amputation. To ease the agony and strengthen the bones, doctors prescribed $1.4 billion worth of a bone-boosting drug called Zometa, from Novartis, in 2008. Denosumab could be bigger, some analysts say—in part because patients receive it in simple injections while Zometa requires lengthy infusions.

Denosumab is a synthetic antibody that inhibits a protein the body uses to break down old bone. The protein is part of a natural replenishing process, but too much of it can lead to osteoporosis. Cancer also has an insidious way of stimulating production of the protein to facilitate its attack.

If denosumab is approved, Cowen's Gordon estimates that its use for osteoporosis might bring in $1.4 billion annually by 2014. If it also proves effective against bone metastasis, sales could soar to $6 billion, nearly twice as much as the drugmaker's current top seller, he says.

Amgen investors are paying close attention partly because the Thousand Oaks (Calif.)-based company has taken a beating in recent months. Its stock fell 2% in 2009 while the Nasdaq Biotech Index rose 16%. That drop came after sales of Amgen's anemia drugs, accounting for 34% of revenue, fell 16% in two years through 2008 because of safety issues. Studies supporting denosumab's cancer benefit could boost Amgen's shares about 20% this year, analysts say.

Fortifying weakened bones may bring myriad benefits

ANTITUMOR EFFECT?

Even if the FDA approves denosumab for osteoporosis, however, no one can predict how well it will perform against bone metastases. The first indication will come sometime this year when Amgen releases initial results of a trial involving 1,400 prostate cancer patients. Dr. Matthew R. Smith, the research chief who heads the study at Massachusetts General Hospital in Boston, says the drug has a good chance of succeeding. "The bone microenvironment is very rich soil for cancer to grow," he says. "Denosumab changes that microenvironment by inhibiting bone turnover. It may also have a direct antitumor effect."

Once approved, how will denosumab fare against Zometa and other bone-strengthening drugs on the market? Early signs look good. At the recent San Antonio Breast Cancer Symposium, a study of denosumab's impact on bone strength showed it cut the rate of fractures and other bone complications in patients with breast cancer better than Zometa and had fewer side effects. Amgen says it expects to release data from a similar study on building bone strength by the end of March. | BW |

$6 billion

Potential annual sales in 2014 of Amgen's experimental bone-boosting drug if it proves effective against metastatic cancer

Data: Cowen & Co.

PROFESSOR PIETRO M. MOTTA/PHOTO RESEARCHERS

www.storemags.com & www.fantamag.com

STRATEGY & COMPETITION

IBM Piles Up Patents, But Quantity Isn't King

Although Big Blue regularly rakes in more patents than its peers, Microsoft's are more valuable

By Steve LeVine

No one beats IBM on patents. For 17 years running, Big Blue has been granted more U.S. patents than any other applicant, raking in an unprecedented 4,914 in 2009. That tally is more than the number of patents granted last year to Microsoft, Hewlett-Packard, Oracle, Apple, Accenture, and Google combined. IBM's worldwide portfolio now covers more than 40,000 inventions for everything from microprocessors for video games to the erasable read-write CD.

Quantity, however, is not the same as quality. "The arms race approach doesn't pay off," says Mark Chandler, general counsel of Cisco Systems. "It doesn't do you a lot of good just to have a lot of patents." A study conducted for *Bloomberg BusinessWeek* by Ocean Tomo, a Chicago intellectual property consulting firm, concludes that IBM's collection of U.S. patents over the past five years ranks only eighth in value. No. 1 is Microsoft, which had 2,906 patents last year and ranked third in number.

IBM is hardly a creative has-been. The company maintains one of the last university-like laboratories in American business and, based on outlays through the first three quarters of 2009, spent $5.8 billion on research and development last year, or 6% of total revenue. Aside from protecting its products and services from imitators, IBM's patents produce considerable income—fees from licensing and custom-developing intellectual property for other companies through Sept. 30 were on track to top $1.1 billion in 2009. "Their patent department is a profit center," says Bruce Lehman, former head of the U.S. Patent & Trademark Office and now chairman of the International Intellectual Property Institute, a Washington think tank.



The race for patents is not just a matter of bragging rights. Pfizer relies on a single set of patents for cholesterol drug Lipitor for a fourth of total sales, or an estimated $11 billion last year. Qualcomm collects almost all its revenue—$10.4 billion in 2009—from licenses for and chips containing its patented 3G mobile-phone technology known as CDMA.

GAUGING INNOVATION

IBM may be shortchanging itself, according to the Ocean Tomo study. To determine the firepower of companies' patent portfolios, the consulting firm analyzed five years of patents awarded to the world's 1,000-largest public companies by revenue. Among the dozens of measuring sticks Ocean Tomo used to judge the significance of a company's breakthroughs were the number of prior patents cited, patent renewal payments, and litigation.

In all, Microsoft's portfolio was assessed at 3.3 times that of IBM's. "This is something that IBM people won't accept, but it's accurate nonetheless," says Steve Lee, president of Ocean Tomo's patent rating division. He says IBM's portfolio includes a large number of service-related patents, which do not command as high a price as the video-game and software patents that heavily weigh in Microsoft's portfolio. "The ultimate value is not some rating," says Manny Schecter, IBM's chief patent counsel. "It's the leverage we are able to get from the patent [licensing] negotiations.

At Microsoft, Horacio Gutiérrez, the company's chief intellectual property officer, says patents are treated not as a profit center but "as a currency that you use to trade to another company" for its patents. Volume is an important gauge of a company's innovation, he adds, but "only if they are high-quality patents." |BW|

ACME ILLUSTRATORS

www.storemags.com & www.fantamag.com



CEO Schaden won't keep trying to match Subway's low prices

STRATEGY & COMPETITION

Damn! Torpedoes Get Quiznos Back on Track

The sandwich chain swears by rapid-fire taste tests that help it give customers what they want

By Michael Arndt

Quiznos has always positioned itself as a cut above Subway in the fast-food market—and priced its sandwiches accordingly. These days, however, value is what sells. After a two-year slide, Quiznos is proving it can be as deft as the submarine king, helped in large part by a yesteryear approach to market research.

Quiznos reconnected with the frugal-who-lunch last March, by offering the $4 Toasty Torpedo, a 13-in. sandwich on a thin loaf of *ciabatta* bread. It did it again in July with an 8-in. version, the $3 Toasty Bullet. And in October the company expanded its bargain options with a Bullet plus soup or salad combo for $5. Since the Torpedo's launch, Chief Executive Richard E. Schaden says, sales have been flat, even as industrywide revenue has declined and stalwarts such as McDonald's have reported drops in U.S. traffic. "Flat is the new up," says Darren Tristano, executive vice-president of food-service consultancy Technomic.

Quiznos seems to have put internal turmoil behind it, too. The privately

PHOTO-ILLUSTRATION BY JAMIE KRIPKE

www.storemags.com & www.fantamag.com



held company has had three CEOs in three years, including Gregory Brenneman, who took over in 2007 after three years as Burger King chief. Brenneman is now executive chairman, while Schaden, who founded the chain in 1991, reclaimed the CEO spot last February. Quiznos also just settled four class actions by franchisees, agreeing to pay $114 million in compensation for disputed food and marketing fees. Over the three-year legal fight, the number of franchised restaurants slipped 10% in the U.S., to 4,100 today.

"A LITTLE DATED"

Management was thrown for another loop when Subway slashed prices on foot-long subs to $5 in spring 2008. Denver-based Quiznos responded by lowering its prices too. But the discounting ate into margins and didn't lift sales. Quiznos also cut back on product development. In late 2008, though, as rising joblessness and Subway's cheap prices took more lunchtime customers away, Schaden decided to reconvene test groups to find new sandwiches.

While restaurant operators regularly enlist consumers for feedback, many have turned away from focus groups. Panera Bread, for instance, asks customers to try new products individually in restaurants, to avoid the peril of group think. Andrew Stefanovich, a senior partner at Prophet, a marketing consultancy in San Francisco, says a shortcoming of focus groups is that consumers can only react to what they're fed, and not propose something new. "Frankly, it's a little dated," he adds.

Quiznos executives nonetheless swear by their speed-dining approach, empaneling as many as 25 groups in back-to-back, 90-minute tastings. By reworking recipes based on snap reviews, Quiznos can get products from test kitchen to the market in six months. Panera requires at least a year. Quiznos also can find the right ingredients, portion sizes, and pricing that ensure healthy profits before moving ahead.

Now Quiznos is gunning for upmarket consumers, too, with two new subs priced at up to $7.49. That may seem foolhardy, with unemployment at 10%. But Schaden is confident. After all, focus groups ate them up in October. | BW |

DANIEL ACKER/BLOOMBERG

MANAGEMENT & LEADERSHIP

Yahoo Opens Its Checkbook

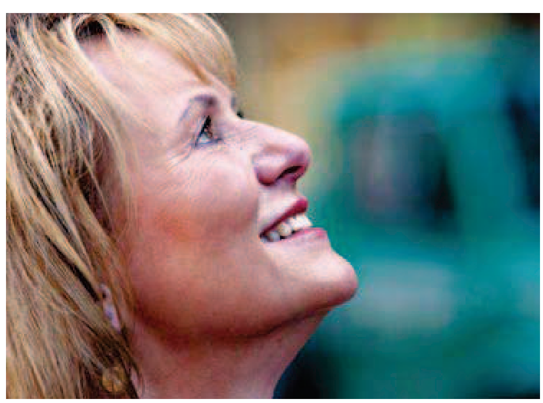
CEO Bartz steps up acquisitions and stresses local content to stay relevant in the Age of Twitter

By Brian Womack

Less than three minutes into an interview at Yahoo!'s Sunnyvale (Calif.) headquarters, Chief Executive Carol Bartz is eager to tell reporters how she would grade her first-year performance: She gives herself a B-. Dealmaking may help her work up to an A.

"You're going to see more acquisitions this year," says Bartz, 61, who in January 2009 replaced Jerry Yang as CEO of Yahoo, the Web portal that organizes online information, provides e-mail, and sells Internet advertising. Potential targets include overseas companies and data analytics businesses that help companies assess their advertising results, she says. "Last year people talked about, 'Oh, Yahoo is trying to get smaller,'" Bartz says. "We were never trying to get smaller. We were just trying to get more focused."

Bartz is looking for global purchases that will bring Yahoo more users



Yahoo's priority is stemming a year-long sales slump and staying relevant as upstarts Twitter and Facebook reshape how people communicate, and rival Google increases its lead in search-related ads. "It's really important, especially as the economy starts coming back," that Yahoo step up dealmaking, says Gartner analyst Andrew Frank. Bartz, previously CEO of Autodesk, says she's interested in ways to bolster Yahoo's local content. "Local is extemely important," she says in response to a question about whether Yahoo might try to buy Yelp, which lets users post reviews of nearby businesses. "People do some outrageous percentage of their commercial spending five miles from their home." Google recently halted talks to buy Yelp, says a person familiar with the negotiations.

Bartz is interested in purchases that bring Yahoo more users, "whether it's a place like Mexico, a place like Brazil," she says. In 2009 Yahoo bought Arabic Web site Maktoob.com and, with a partner, Australian travel site totaltravel.com.

Yahoo is also preparing to collaborate with Microsoft in Web search and advertising. The deal, which is awaiting regulatory approval, would let Yahoo cut capital spending by a projected $200 million. Gene Munster, an analyst at Piper Jaffray in Minneapolis, says Bartz may be able to lift annual sales growth to 10%. "We believe in Carol Bartz and believe that she is going to get the revenue growth to a point that's acceptable," he says. | BW |

www.storemags.com & www.fantamag.com

ECONOMICS & POLICY

Europe's Delicate Dilemma

Which EU countries are having the biggest financial problems? Hint: Oink, oink

By Mark Scott

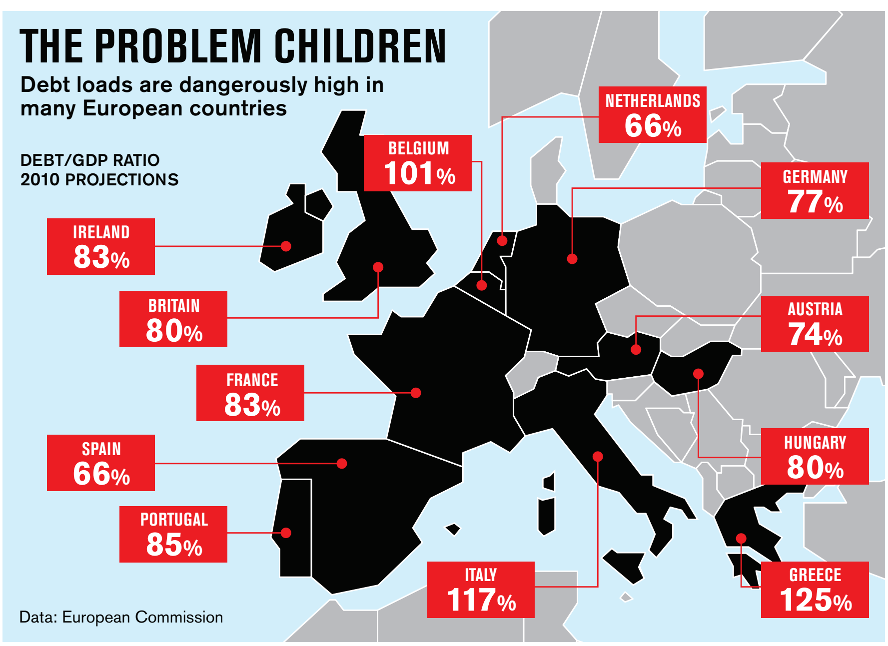
LONDON

When a patient is on life support, it's not typically advisable to squeeze the oxygen hose. But that's just what European policymakers may be forced to do. The region's economy contracted by 4.1% last year and is expected to show growth of just 0.7% in 2010 as stimulus spending takes effect. With government debt growing and Greece and Ireland flirting with default, though, leaders across Europe may have to cut some of that oxygen—risking a tumble back into recession. "If cuts come too quickly, they could stifle the recovery," says Jamie Dannhauser, an economist at consultancy Lombard Street Research.

The ratio of overall debt to gross domestic product in the European Union—a key indicator of fiscal health—will jump to almost 80% this year, according to the European Commission. While that's shy of the 89% level in the spendthrift U.S., it's up from 60% in 2007. For this year, the combined deficits of European governments will hit 6.7% of GDP, more than double the 3% mandated under EU law. In Greece, Britain, Latvia, and Spain, the 2010 shortfall is in double digits.

Taxes must be raised, big infrastructure projects scaled back, and bureaucrats' pay cut if debt is to be reduced. But many experts fret that governments may be moving too fast. "A balance needs to be struck between a relatively weak recovery and rising debt levels," says Sebastian Barnes, senior economist at the Organization for Economic Cooperation & Development in Paris. "Some countries find themselves in extremely difficult positions."

That's particularly true for the so-called PIIGS: Portugal, Italy, Ireland, Greece, and Spain. Fears of default have spurred international ratings agencies to downgrade their sovereign debt, making it costlier for them to raise money. "Uncertainty is poison for market confidence," says Alistair Milne, a finance professor at the Cass Business School in London.



VOTER ANGER

Ireland, where the credit-fueled housing market shrank by a fifth last year and the economy contracted 7.5%, slashed $5.8 billion from its 2010 budget of $87 billion. That includes lower unemployment benefits, reduced subsidies to parents of young children, and pay cuts of 5% to 15% for government workers. Greece plans to free up $6.5 billion by freezing civil servants' pay, raising taxes on high-end property, and increasing levies on cigarettes and liquor by 20%. France aims to raise $4.4 billion annually by charging $25 per metric ton of carbon dioxide emitted by cars, home furnaces, and factories. Britain will probably increase its retirement age and cut welfare programs, though nothing is likely to happen before a national election this spring.

Mounting voter anger could temper politicians' plans. Strikes are planned in Greece, laborers in Spain have balked at lower jobless benefits, and Irish workers have taken to the streets to protest the cutbacks. "Short of selling our kidneys, we don't know how we're going to [pay our bills]," says Brian Condra, 38, a hospital orderly and father of three from the Irish coastal town of Drogheda. He expects his family's take-home pay to drop by some $360 monthly, and that's on top of $500 a month in new taxes introduced last year. "I went around for the last four months needing new shoes," adds Condra, who clearly has a gift for pungent language. Now "I will have to be walking around in my bare feet." | BW |

—With Louisa Fahy

MAP BY DAVID FOSTER

www.storemags.com & www.fantamag.com



ECONOMICS & POLICY

Greenhouse Gas Cuts, One Way or Another

The EPA will soon crack down on emissions—pressuring Congress to pass a climate bill of its own

By John Carey

The Copenhagen summit aimed at limiting greenhouse gases ended with a whimper. Climate legislation in Congress is stumbling. But curbs on U.S. emissions from power plants and factories are coming anyway.

The Environmental Protection Agency is poised to take an historic step at the end of March, issuing the first-ever national rules to fight climate change. That puts companies on edge. "With the economy still limping, it's not the right time for this massive increase in the cost of everything we do," says Michael G. Morris, CEO of American Electric Power (AEP).

EPA officials insist that fears about the new rules are overblown. "The EPA will act decisively and with common sense," Gina McCarthy, head of air regulation, said at an event in Copenhagen. Yet such assurances aren't stopping opponents such as Senator Lisa Murkowski (R-Alaska), Governor Bobby Jindal (R-La.), and the U.S. Chamber of Commerce from questioning the agency's authority. Many environmentalists think there's a better approach than rigid bureaucratic rules requiring states to act. David Bookbinder, chief climate counsel at the Sierra Club, sees regulation as "truly the second-best option to legislation" and hopes the threat will make companies urge Congress to pass a climate bill.

LEGAL WRANGLING

Here's how the regulations came about—and what they'll do. In 1999 environmentalists and renewable energy advocates petitioned the EPA under the Clean Air Act to limit the carbon dioxide coming from car exhaust. Eight years of legal wrangling later, the Supreme Court sternly admonished the agency. Yes, the justices said, CO_2 is a pollutant, and you'd better regulate auto emissions or explain why not.

Joubert: Capturing carbon emissions is "possible and economically viable"

The Bush White House stalled, but the Obama Administration swiftly worked out a deal with the auto companies to boost fuel economy and cut emissions. On Dec. 7 the EPA provided the formal justification, ruling that greenhouse gases are a threat to health and welfare. It plans to finalize the tailpipe rules by the end of March.

What does this have to do with power plants? "Under the Clean Air Act, there is a domino effect," explains Kyle W. Danish, a climate law expert at Van Ness Feldman, a Washington (D.C.) law firm. Once a pollutant is regulated, "it triggers a whole bunch of requirements." Any new or significantly upgraded source of emissions must get a "prevention of significant deterioration" (PSD) permit saying that the "best available control technology" has been used to limit pollution.

The approach isn't ideal. "The Clean Air Act is a blunt instrument," says former Energy Dept. official Joseph J. Romm. For one thing, the law requires a PSD permit for new or revamped facilities that emit more than 250 tons of a pollutant per year. This threshold may be practical for trace pollutants such as sulfur dioxide, but not for CO_2, which

SAUL LOEB/AFP PHOTO

www.storemags.com & www.fantamag.com



is spewed in large amounts by power plants, factories—even the local bakery. Hundreds of thousands of businesses exceed the limit; the rule would snare an estimated 41,000 new or improved facilities each year. "It would be an economic wrecking ball aimed straight at small business," says Marlo Lewis Jr., senior fellow at the conservative Competitive Enterprise Institute. Even the EPA agrees the law would have absurd results. It plans to change the threshold to 25,000 or even 50,000 tons annually, at which point fewer than 400 PSD permits would be needed per year.

THREADING THE NEEDLE

The second big issue involves defining "best available control technology." One idea, capturing carbon from smokestacks, is "possible and economically viable," says Philippe Joubert, president of France's Alstom Power, which makes such equipment. But the Clean Air Act requires control technology to be commercially available; gear such as Alstom's is still being tested. So the EPA's coming guidance will start out specifying energy efficiency measures. Later it could steer companies to switch from coal power to natural gas.

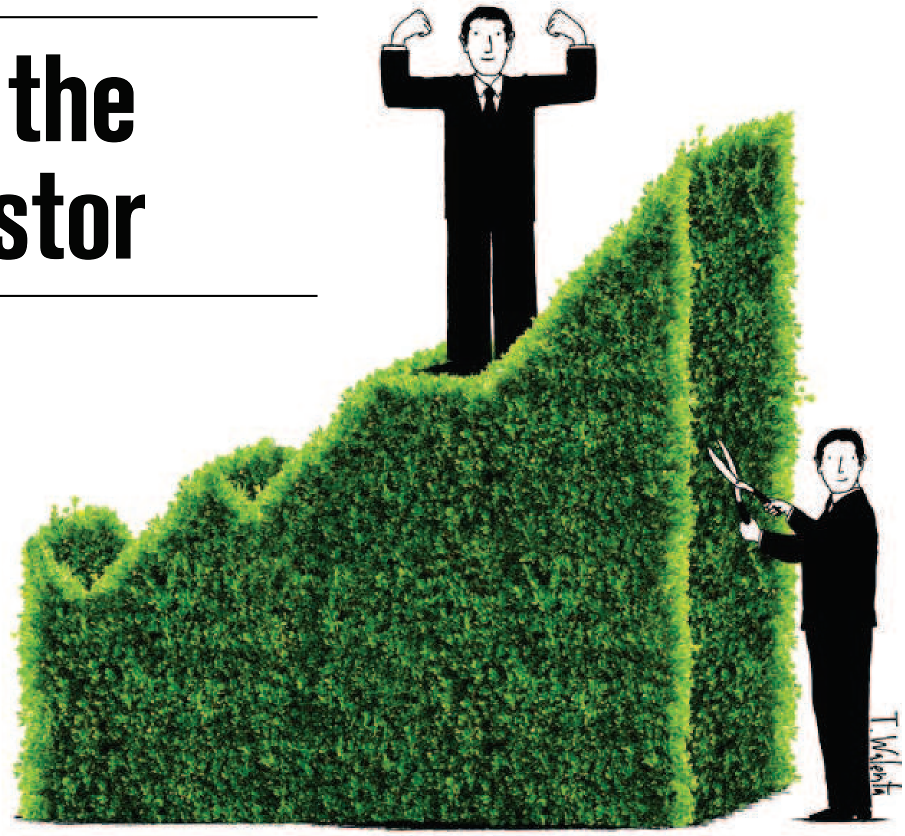
U.S. companies worry, however, that the legal tools available to the EPA are too crude to put them on the best green path. "They are trying to thread this needle between being too onerous and too ineffective," says Steven B. Corneli, senior vice-president for market and climate policy at the utility NRG Energy. "I'm afraid it's likely to be both."

Environmentalists counter that the EPA's action, while not optimal, is still progress. "The good news is that a lot can be done with regulation," says Bookbinder—including, eventually, cracking down on existing power plants. Even the utilities see positive potential outcomes. "There are ways the EPA could go about it that are rational and could work," says AEP's Morris. But the politics are also crucial. If the rules survive legal challenges and kick in by summer, as the EPA expects, the first big impact may be to urge lawmakers to devise a more comprehensive approach. Says Corneli: "We respect what the EPA is doing, but it makes it more urgent that Congress act." | BW |

www.storemags.com & www.fantamag.com

FINANCE

Revenge of the Hedge Investor



Big returns aren't enough to keep angry clients from pulling out of funds that blocked withdrawals

By Saijel Kishan and Katherine Burton

Since their record losses in 2008, hedge funds have staged a comeback, posting a 20% gain last year. So why are many investors still wary?

Partly it's because they could have made more in the S&P 500-stock index, which returned almost 27% in 2009, and avoided those pesky, high fees. Some simply aren't happy with the way they were treated when hedge funds barred redemptions during the market's darkest days. Pension funds, foundations, and wealthy individuals yanked $118 billion from hedge funds in the first 11 months of 2009, and many continue to hoard cash. "Before, managers could rely on their returns to sell themselves," says Andrea Gentilini, head of strategic consulting at Barclays Capital's Prime Services unit in New York. "Now investors want more transparency and communication."

Citadel Investment Group, the $13 billion Chicago money management firm run by Ken Griffin, lost 55% in 2008 and suspended withdrawals for much of 2009. Despite returns that soared 62% last year, clients nonetheless pulled $500 million from the firm. "Some managers that prevented investors from getting their money back have done terrible long-term damage to their businesses," says Simon Atiyah, an attorney at London-based law firm Lovells, which represents hedge funds. Citadel declined to comment.

$118 billion

The amount investors pulled from hedge funds in the first 11 months of 2009.

Data: EurekaHedge

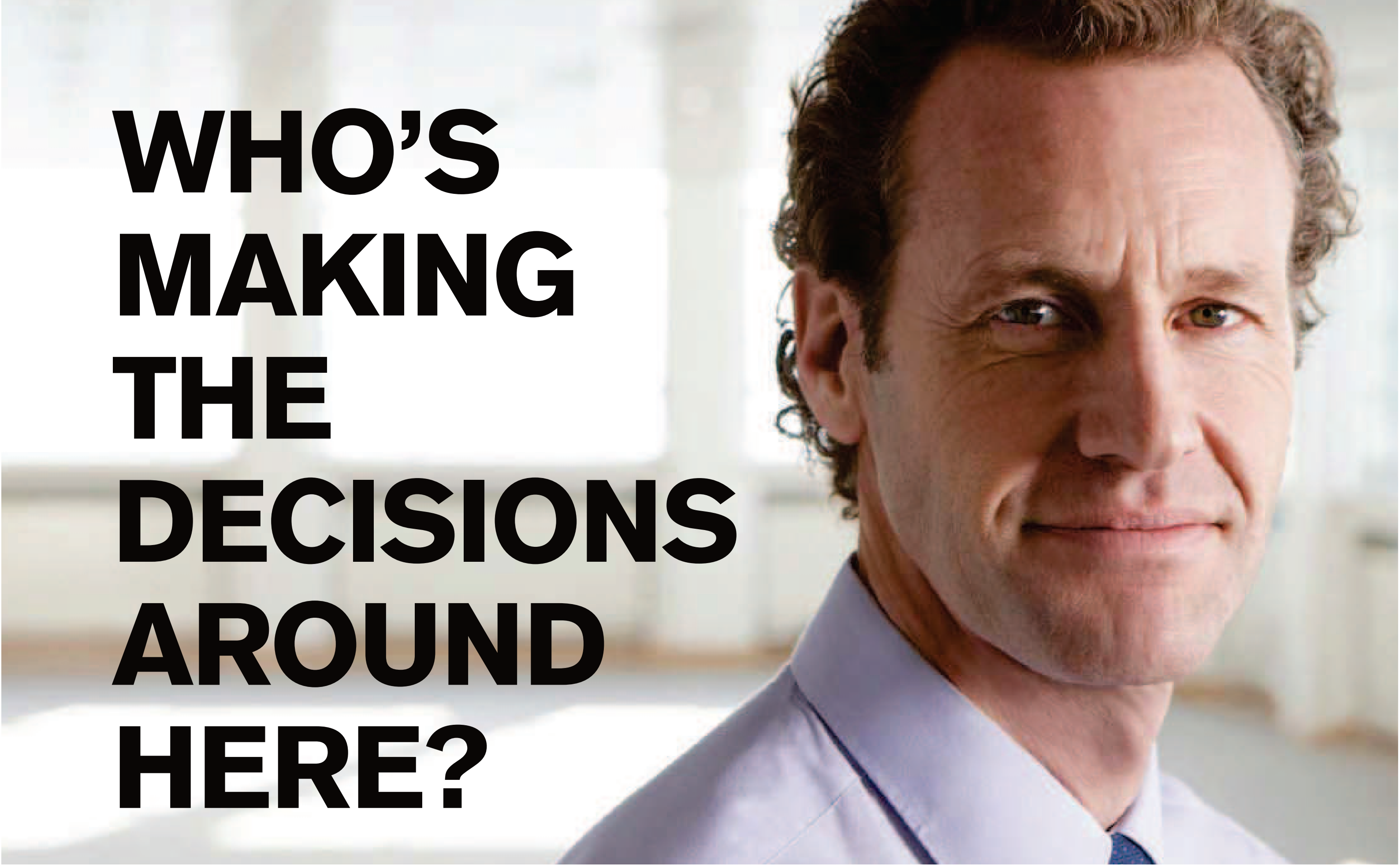
Amit Shabi, a Paris-based partner at Bernheim Dreyfus, a money manager, says his firm won't invest in any hedge fund that imposed restrictions on withdrawals. "Many managers acted like traitors," he says. Drake Management, the New York firm founded by former BlackRock managers, had to shelve plans for a new fund late last year after it couldn't drum up enough cash. The firm shut its flagship vehicle in 2008 and suspended redemptions. Investors are still waiting to get their money back. Drake declined to comment.

Meanwhile hedge fund firms that allowed withdrawals during the downturn have become so popular that they're turning money away. At least six funds—including Paul Tudor Jones' BVI Global Fund, Brookside Capital Partners, an affiliate of Boston-based Bain Capital, and the $21.3 billion Brevan Howard Master Fund—are limiting new cash because their assets have ballooned. It's a step managers take when they feel their funds have gotten too big to run effectively. The firms declined to comment.

These portfolios have attracted cash with a combination of consistent, long-term gains and investor-friendly behavior. Jones, the 55-year-old former commodities trader whose BVI Global has returned an average of 22% a year since it was started in 1986, briefly suspended withdrawals from the fund in November 2008. The firm then quickly placated clients by returning some of their money. It paid off: Between March and July, investors put $1.3 billion into BVI Global. Says Debra Pipines, founder of New York-based Asperion Group, which raises money for hedge funds: "Managers that honored their agreements and treated their investors as partners during the last 18 months of economic difficulties are being rewarded with additional money." | BW |

TOMASZ WALENTA

www.storemags.com & www.fantamag.com



YOU ARE.

Thirty percent more *Bloomberg BusinessWeek* readers are directly involved in purchase decisions than the readers of *Forbes*, *Fortune*, or *The Economist*.

We deliver the most coverage of critical business topics—week in and week out—so it's no surprise the most influential professionals have always relied on us to help make smarter decisions in business and in life.

Bloomberg BusinessWeek

The clear leader in moving business forward

TO SUBSCRIBE

Don't miss an issue!
Visit: businessweek.com/subscribe
800-635-1200

TO ADVERTISE

Contact Jessica Sibley
jssibley@bloomberg.net
212-512-6900

Source: PIAB, 2008-9; Hall's Magazine Reports, Full Year 2009.

www.storemags.com & www.fantamag.com

62 How to Play It: Apple vs. Google
63 Investing: Bank stocks
64 Investing: Fund managers

PERSONAL BUSINESS



MONEY REPORT

GRIEF FOR GREENBACKS

The Australian and Canadian dollars will keep gaining on the U.S. dollar in 2010, appreciating at least 3% and 7.5%, according to Bloomberg's top forecasters for each currency. U.S. growth will spur demand for Canadian oil and natural gas, and China should boost purchases of Australian iron ore and coal, which will push the currencies higher, says Sacha Tihanyi, a foreign exchange strategist at Bank of Nova Scotia. ¶ In the two years following the 2001 recession, the currencies traders dub the Aussie and loonie rose 48% and 23%, respectively. Since last year's lows, the Aussie is up 49% and the loonie 27%. On Jan. 11, $1 U.S. bought 1.08 Australian and 1.03 Canadian. John Kyriakopoulos, head of currency strategy at National Australia Bank, thinks the Aussie will reach parity with the U.S. dollar and that by March it may take more than $1 U.S. to buy $1 Canadian. He sees 11% gains for each by Sept. 30. ¶ For pure plays, CurrencyShares has the Canadian Dollar Trust and Australian Dollar Trust. *–Oliver Biggadike and Candice Zachariahs*

STOCKS

Q4 EARNINGS: CHEERS!

Time to take the champagne out of the fridge. Alcoa reported net income of $0.01 a share on Jan. 11—the first major earnings announcement this season and a big change from the $0.28 loss reported one year earlier. John Butters, director of U.S. earnings at Thomson Reuters, predicts the Standard & Poor's 500-stock index will report "unusually high" growth of 184% in fourth quarter 2009. On Jan. 1, 2009, analysts had estimated that figure at 30%.

Financials are expected to see the biggest bounce, with $2.4 billion in net income vs. 2008's $81 billion Q4 loss. Consumer discretionary, materials, and telecom are forecast to post solid year-over-year gains. Industrial and energy companies are expected to have lower earnings, with losses forecast at international freight company CSX (-16%) and energy giant ConocoPhillips (-5%). *–Tara Kalwarski*



Rolling: An Alcoa aluminum factory in Hungary

FUNDS

NOT-SO-HEAVY METAL

Following 2009's launch of gold and silver exchange-traded funds backed by the physical metals, London-based ETF Securities launched similar products for platinum and palladium (used in catalytic converters, among other things). The ETFS Platinum Trust and ETFS Palladium Trust track daily prices of the metals, which rose 57% and 118%, respectively, in 2009.

118%

2009 gain in the price of palladium

Data: Bloomberg

ETFS product development head Fred Jheon says speculation by investors who take profits when metal prices rise won't affect the new ETFs' returns. Rather than track a basket of futures contracts like some commodity ETFs, each share of these ETFs is always worth the equivalent of 0.1 ounce of the corresponding metal. The expense ratios on each of the new ETFs are 0.60%. *-T.K.*

(FROM TOP) JACK ATLEY/BLOOMBERG NEWS; SEAN GALLUP/GETTY IMAGES

www.store

HOW TO PLAY IT | APPLE VS. GOOGLE



(FROM PAGE 28)

By Ben Steverman

The heated rivalry between Google and Apple extends to the stock market, where their shares jostle for pride of place in many technology investors' portfolios. With Bloomberg data showing the price-to-earnings ratios of both stocks higher than 85% of the companies in the Standard &Poor's 500-stock index, they may struggle to meet investor expectations.

Investors flocked to Google and Apple in early '09 as it became clear that even a severe recession wouldn't stall them. Last year, Google's share price doubled; Apple's shot up 147%. Apple may be more likely to support its premium valuation. A long record of successfully jumping into new products leads many tech experts to see it as a pricey, but less risky, play. Google, 22 years younger, is still trying to expand beyond its core expertise in Net search.

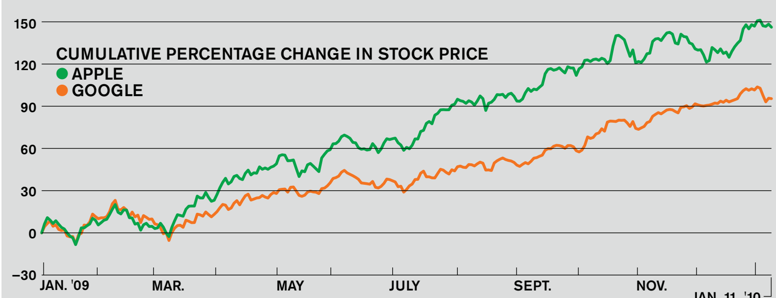
Alan Lancz, of wealth manager Alan B. Lancz & Associates in Toledo, Ohio, started buying Google and Apple shares in December, 2008. He stopped buying when Google, now at 600, passed the limit of 365 he had set for the stock last April. Apple, now at 210, passed his limit of 130 last May. Lancz raised his six-month price estimates in November, to a range of 620 to 680 for Google and 215 to 235 for Apple. "We like the companies but definitely wouldn't be buying them now," he says.

Google may prove more vulnerable to a weaker-than-expected recovery. In 2009, it maintained earnings growth by cutting costs, but sales growth over the past 12 months has slowed to 8.4%, from 31.4% a year ago. (Apple's sales rose at a 12.5% rate over the past year, about half the growth rate of a year ago.) "So much of Google's business model is based on advertising," says Michael Shinnick, a portfolio manager at Wasatch Advisors in South Bend, Ind. Web competition is pushing ad rates lower at the same time that the economic downturn has forced advertisers to slash their budgets. "It's going to be tougher for Google to put up the type of revenue they have had in the past few years," says Shinnick. The average analyst prediction for Google's sales growth is 16%, according to data compiled by Bloomberg, and 23% for Apple.

ECONOMIC WILD CARD

Apple has shown a bit more resistance to the slowdown, and some analysts predict a bump from strong holiday results when it reports earnings on Jan. 25. Its advantage has been a steady rollout of new products that customers love. "I cannot point to another tech titan that has been able to innovate outside their primary product area," says Michael Pytosh, a technology analyst for the ING Growth & Income Fund. (His fund holds Apple but not Google.) Apple investor Ankur Crawford, vice-president and analyst at Fred Alger Management in New York, notes that despite the popularity of Macs and iPhones, Apple still has a tiny share of the market in personal computers and handsets. "[Apple] can essentially double their share in PCs and handsets," she says.

PRICEY TECH PLAYS



Data: Bloomberg

As dominant players in fast-growing markets, both Apple and Google have advantages that justify paying more for their stocks than for those of rivals. In mobile phones, for example, competition could benefit both companies as they win market share from more established players. Still, serious challenges remain, and the markets they're in are changing rapidly. Tech consultant John Metcalfe frames the ongoing drama this way: "Google doesn't know what it's going to be yet. It's like [a batch] of corporate stem cells–genes trying to arrange themselves. Apple on the other hand, knows exactly what its game is. That's what makes this so fascinating." |BW|

www.storemags.com & www.fantamag.com

INVESTING

FINANCIAL STOCKS

DO YOU DARE BUY BANKS?

By Lynn Thomasson

No U.S. industry has faster profit growth than banks and brokers, and no group is more bad-mouthed by investors. It may be time for them to get over their distaste, says Mark Giambrone, a fund manager for San Antonio-based USAA Investment Management, which oversees about $74 billion. "The stocks are clearly too cheap," says Giambrone, whose USAA Value Fund owns Wells Fargo, PNC Financial Services, and Bank of America, among other financial stocks. "There may be some bumps in the road ahead, but for the most part those are reflected in valuations." The Standard & Poor's 500 Financials Index of 78 banks, brokerages, and insurance companies is down 60% since peaking in February 2007, more than twice the drop of the S&P 500-stock index.

Many of Giambrone's peers remain unconvinced that all the pain has been taken in financial stocks. A survey by Bank of America found financial shares the least favored stocks among 123 money managers. But earnings at financial companies rose an estimated 120% in the fourth quarter, accounting for all the income increase in the S&P 500, data compiled by Bloomberg show. Those financial company earnings should triple by 2011, climbing four times as fast as the market, analysts figure. Should those estimates prove correct, financial shares are trading at about a 15% discount to the S&P 500.

16%

Rally expected for financial stocks in the S&P 500 in 2010, based on analyst forecasts

Data: Bloomberg

THE BIGGEST GAINER

Analysts are more bullish on financial stocks in the S&P 500 than on any other sector, based on average share-price forecasts. Those calculations call for a 16% rally over the next 12 months. That would follow the group's 140% runup since last March, which was spurred by better economic data and government rescues of companies from Citigroup to American International Group.

Investors in financial shares will get a lot of information to mull over in the next few weeks. Goldman Sachs, American Express, and 26 other S&P 500 financial companies are scheduled to release earnings by Jan. 22. Bank of America is forecast to post the largest gain among the biggest U.S. banks. Profit may climb to 95¢ a share in 2010 from a 19¢ loss last year, analysts estimate. "What we're looking at is an improvement in the economy that will result in consistent declines in loan losses over the next two or three years, which will result in huge increases in bank earnings," says Richard Bove, an analyst at Stamford (Conn.)-based Rochdale Securities. Favorites of Jennifer Thompson, of New York-based research firm Portales Partners, include PNC Financial Services and Fifth Third Bancorp, which she says are poised to rally.

Some money managers worry that rising interest rates will hurt bank interest margins. Bob Doll, who helps oversee $3.2 trillion as vice-chairman and chief investment officer for global equities at BlackRock, thinks that investors need more proof that all the bad news is factored into bank stocks. "Are all the assets that are classified as performing going to perform?" he asks. "That is the concern. We would wait for some price pullback and have patience before buying." | BW |



ARTHUR GIRON

www.storemags.com & www.fantamag.com

FUND MANAGERS

BETTING THEIR OWN MONEY

By Lewis Braham

Bruce Berkowitz believes in treating his shareholders as he would treat himself. You can see why—Berkowitz and his 30 employees have $150 million of their own money invested in the $11 billion Fairholme Fund. The bulk of that $150 million belongs to Berkowitz.¶ According to a July 2009 study by fund tracker Morningstar, managers with more than a $1 million stake in their own funds beat 58% of peers, on average, over the past five years. Funds with no manager investment beat 46% of peers. Fairholme's 13.2% annualized return has outperformed 99% of peers over 10 years. On Jan. 12, Morningstar named Berkowitz one of three "Fund Managers of the Decade."

Funds began to disclose manager investments only in 2005, after the Securities & Exchange Commission changed disclosure rules. So the research is preliminary. And the level of disclosure is poor—managers need only report their holdings in broad bands that start at $0 to $10,000 and stop at "over $1 million." Beyond that it could be $1.1 million or $150 million. (For trustees on fund boards of directors, the disclosure cap is $100,000.)

More than half of the 4,383 U.S.-based funds in the 2009 study had no manager investment; 413 had investments of over $1 million. "It can be hard for younger managers who've just been promoted to invest more than $1 million in their funds," says Laura Lutton, Morningstar's editorial director of fund research. "But I have a hard time understanding why so many managers would not invest anything at all."

Some fund companies use compensation to try to ensure that the interests of managers match up with those of shareholders. A Fidelity spokesperson says that while fund managers are encouraged to invest in at least one fund they manage, compensation "is largely driven by fund performance, which ... aligns their interests with the interests of our shareholders." That performance-based compensation "is measured against an appropriate benchmark index and peer group over multiple periods as long as five years."

Four years ago, Royce & Associates, a New York-based fund firm with $28 billion in assets, created a policy requiring lead portfolio managers to invest at least $1 million in their funds. Co-portfolio managers must invest $500,000 and assistant managers $250,000. "If you're young and don't have enough money, we will defer your quarterly bonus into the fund," says Jack Fockler, Royce's managing director. As a result, the firm's 100 employees have $100 million invested in its funds.

Then there's Southeastern Asset Management, parent of the three Longleaf Partners Funds. "If you work for Southeastern or your spouse works for Southeastern, you cannot



Fairholme Fund's Berkowitz has many millions of his own money in the fund

(BOTTOM) PHOTOGRAPH BY JOSH RITCHIE

www.storemags.com & www.fantamag.com

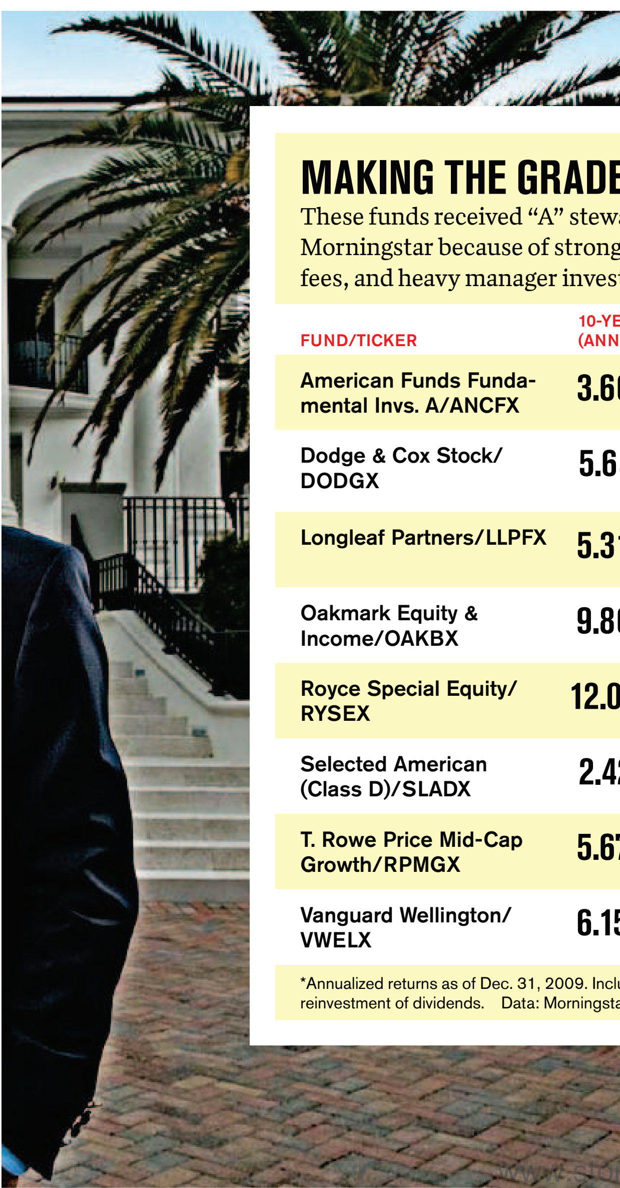
own individual stocks or other non-Longleaf mutual funds," says Lee Harper, a Southeastern spokesperson. Spouses of Southeastern employees who don't have Longleaf funds in their companies' 401(k) plans must get approval from an "exception committee" before participating. The firm's 55 employees and its charitable foundation are the funds' largest shareholders, collectively owning $1 billion in fund shares. The Longleaf Partners Fund has beaten 96% of its peers over the past 10 years.

Fund companies with heavy manager investment tend to be boutique firms. Yet at some big fund companies, including Janus, T. Rowe Price and Dodge & Cox, manager ownership is also part of the corporate culture. Janus in particular has long had a culture of ownership. Its 54 analysts and money managers have $113 million invested in its funds. Since 2005 the firm has paid half of fund manager/analyst bonuses in fund shares, and shares vest over four years. "The day I became manager of Janus Fund, I invested in excess of $1 million in it," says Jonathan Coleman, Janus' co-chief investment officer and co-manager of the firm's $9 billion flagship Janus Fund. "We have a saying: 'You don't wash a rental car.' We don't treat portfolios as rental cars. We treat them as owners."

(TOP, RIGHT) PHOTOGRAPH BY JOHN S. ABBOTT



Chris Davis: Employees have $1.5 billion invested in Davis Advisors funds



MAKING THE GRADE

These funds received "A" stewardship grades from Morningstar because of strong corporate cultures, low fees, and heavy manager investment in their funds.

FUND/TICKER	10-YEAR RETURN (ANNUALIZED)	% OF PEERS THE FUND BEATS
American Funds Fundamental Invs. A/ANCFX	3.60%	90%
Dodge & Cox Stock/DODGX	5.65	94
Longleaf Partners/LLPFX	5.31	96
Oakmark Equity & Income/OAKBX	9.80	99
Royce Special Equity/RYSEX	12.02	97
Selected American (Class D)/SLADX	2.42	83
T. Rowe Price Mid-Cap Growth/RPMGX	5.67	89
Vanguard Wellington/VWELX	6.15	97

*Annualized returns as of Dec. 31, 2009. Includes capital appreciation plus reinvestment of dividends. Data: Morningstar

There is evidence of improvement in ownership among fund boards of directors. According to a study of 7,690 funds by fund trade group Investment Company Institute, 28% of funds required directors to own fund shares in 2008, up from 6% in 1996. Longleaf directors, for instance, must own fund shares at least equal in value to their annual directors' salaries. "One of the most important responsibilities of fund boards is to negotiate fees and expense ratios with fund management companies," says Morningstar's Lutton. "When directors are paying some of those fees as shareholders, they have a good incentive to lower those fees for themselves."

A handful of fund companies lead the way in this area. One that makes a big point of employee investment is Davis Advisors. It touts the size of its ownership—about $1.5 billion—at the top of the Davis funds' home page. (Much of that money is from the Davis family, whose patriarch, Shelby Davis, and his son, Chris, built the firm.) Davis, which manages $45 billion in mutual fund assets, has "director stock ownership guidelines" that require directors of its Selected Funds to own in fund shares at least three times the annual amount they are paid to be directors. For independent directors, those annual amounts ranged from $67,500 to $130,000 in 2008. Selected Funds' mutual fund fees are among the lowest in the business.

To find out what a fund's manager ownership levels and policies are, check its Statement of Additional Information, which accompanies its prospectus and can be found at fund Web sites and at Morningstar.com. Morningstar also has stewardship grades that analyze manager incentives and pay structure. (Not all funds are rated yet.) Managers with big investments in their own funds receive an "A" for the incentive part of their stewardship grade. | BW |

www.freemags.com & www.fantamag.com

68 Tech & You: Nexus One
69 Feedback
72 Outside Shot: The bane of innovation

BUSINESS VIEWS



Stiglitz: Obama just "rearranged the deck chairs"

OLIVIER ROLLER/FEDEPHOTO/PIXPALACE

BOOKS By JAMES PRESSLEY

The Meltdown According to Stiglitz

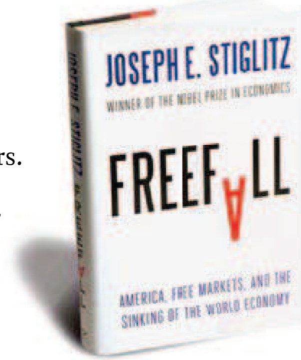
The Nobel prize-winning economist argues that Obama's response to the financial crisis was far too timid

Barack Obama ran for President on the promise of "change we can believe in." When it comes to the financial crisis, he has instead "only slightly rearranged the deck chairs on the *Titanic*," writes Joseph E. Stiglitz in *Freefall*, his unsparing new account of the meltdown and its aftermath.

Stiglitz, a Nobel prize-winning economist, is perhaps the closest thing we have to John Maynard Keynes in both his theoretical

www.storemags.com & www.fantamag.com

outlook and his cogent kibitzing of policymakers. In *Freefall*, he brings his formidable brain to bear on how flawed theories and misguided policies brought us the worst crash since the Great Depression.



***Freefall: America, Free Markets, and the Sinking of the World Economy* by Joseph E. Stiglitz; W.W. Norton & Co., 361 pp; $27.95**

Although Stiglitz spends much of the book exploring what went wrong and why—"peeling back an onion," he calls it—his emphasis is on the future, not the past. The message: We have a once-in-a-generation chance to design "a more efficient and a more stable economy" by readjusting the balance between markets and government. Obama has so far squandered this opportunity, Stiglitz says.

The President did engender a sense of hope, he writes. "And yet, in a more fundamental sense, 'no drama' Obama was conservative," observes Stiglitz. "He didn't offer an alternative vision of capitalism." Obama chose instead to "muddle through"—"to take a big gamble by largely staying the course that President Bush had laid out." He retained two leading members of George W. Bush's economic team, Ben Bernanke and Timothy Geithner. Both have garnered their share of withering criticism—Geithner most recently for the role he played as former head of the Federal Reserve Bank of New York. During the depths of the crisis, it turns out, the New York Fed ordered American International Group to withhold details of payments the insurer made to banks, according to e-mails between the company and its regulator. The New York Fed says Geithner wasn't involved in decisions on AIG's disclosures.

Obama also brought in Lawrence Summers, who boasted of having ensured during his stint as Bill Clinton's Treasury Secretary that derivatives would stay unregulated. These were the deck chairs Obama shuffled as the ship of state listed.

Stiglitz frames *Freefall* as a book about "a battle of ideas." He means the conflict between those who say the market is a wondrous, self-regulating apparatus and those who note that deregulation often wrecks the machinery, as economists Carmen M. Reinhart and Kenneth S. Rogoff showed in *This Time Is Different*, a landmark book released by Princeton last September.

Yet *Freefall* is no academic history of efficient-markets theory. It's more a stream of rat-a-tat dispatches from a military strategist who's tracking troop movements and counteroffensives. After years of crafting policy for the World Bank and the Clinton Administration, Stiglitz knows all the arguments against regulation. He counters them, one by one, and anticipates opponents' moves in detailed and often spunky footnotes. Anyone seeking an easy scapegoat for the crisis—be it government homeownership policy or the existence of the Federal Reserve—won't get much joy here.

Moral outrage courses through these pages as Stiglitz surveys the wreckage: millions of people who have lost their homes and their jobs; a financial sector that used its political influence to secure "a trillion-dollar bailout;" a U.S. public-debt-to-gross-domestic-product ratio that surged to almost 60% in 2009 and is expected to reach at least 70% in the next decade.

Stiglitz' proposals for fixing the mess will be familiar to anyone who follows his public comments. Americans should be prepared for a second dose of stimulus spending after the current round winds down. "When an economy is weak," Stiglitz says, "attack with overwhelming force."

Stimulus money should be spent on investments to build a brighter, more sustainable future, Stiglitz argues. Deficit-financed spending can't last forever, so he calls, more controversially, for heavier taxes on "upper-income" Americans. That phrase is disturbingly vague. If Stiglitz lived in Belgium, as I do, he would know how quickly "upper-income" comes to mean middle-class families handing more than half their wages to the government (excluding taxes on sales, dividends, property, and so on). More sensibly, he wants people to pay a high price for greenhouse gas emissions, which would provide incentives to waste less and innovate more.

Over the longer term, Stiglitz seeks a new vision of the financial system that would return banks to the core functions of providing an efficient payments mechanism, making loans, and managing risk. He also calls for the creation of a new global reserve currency to alleviate the need for countries to stockpile dollars as a safeguard again financial upheavals.

Above all, he urges Americans to pause and reflect on what kind of society they want—and what kind of economy is needed to achieve those goals. Whatever one's opinion of Stiglitz, he offers much to think about in this book. I can only hope Obama makes room for it on his nightstand. |BW|

Business Exchange

Read, save, and add content on BW's Web 2.0 topic network

Financial Circuit Breakers

Joseph Stiglitz is no fan of globalization. In a paper presented at the American Economic Assn.'s annual meeting this January, he writes that given a choice between complete integration of global financial markets and total separation, the latter is better. Stiglitz says the recent crisis shows that just as with power grids, financial networks need proper circuit breakers to prevent a blackout in one part of the grid from ruining the entire system.

To read the paper, go to **http://bx.businessweek.com/globalization/**

www.storemags.com & www.fantamag.com

TECH & YOU

By RICH JAROSLOVSKY

Nexus One: Not A Game-Changer

Google's new smartphone will be the new cool thing—for a month or two. But it won't take the wind from Apple's sails

It's a nice phone. O.K., it's a very nice phone. But nothing about the new Nexus One smartphone from Google comes close to warranting the hysteria that attended its unveiling last week.

The Nexus One isn't revolutionary. Nor is it an iPhone killer—a phrase we should banish to the Tech Writers' Hall of Clichés. It is, instead, a sleek phone running Google's Android operating system, with some advancements in display and processor technology that will surely be matched and then overtaken by others in the months ahead.

True, the rapidly evolving competition among Google, Apple, Microsoft, and Research in Motion is fascinating to watch. And Google's plunge into e-tailing—the Nexus One can only be bought directly from the company over the Web—has the potential to shake up how phones are sold. Still, I find it hard to swoon over a business model.

The Nexus One, manufactured by Taiwan's HTC to Google's specifications, is similar in both size and shape to the iPhone. If anyone ought to feel threatened by it, though, it's Motorola, which committed to using Android for all its smartphones and now must compete with its powerful partner.

The screen on Motorola's Droid used to be my favorite—super-bright, with higher resolution than the iPhone. The Nexus One's display is better: a thing of beauty, with an even richer display and deeper colors. Under the hood, Google's phone has the most powerful microprocessor ever used in a mobile device. And unlike the iPhone, it has a replaceable battery, a memory-card slot, and expanded speech-to-text features so you can dictate your Facebook or Twitter updates, should 140 characters prove too taxing for your fingers.



At the same time, the Nexus One shares the shortcomings of earlier Android and HTC phones. In terms of the number of apps, Android phones trail far behind the iPhone. So does Android's ability to sync with Microsoft Outlook for e-mail, calendars, and contacts. The app icons on the Nexus One are too small and close together. And its 4 gigabytes of storage is inadequate and inflexible—only 190 megabytes are set aside for apps. The home, back, menu, and search buttons below the screen require too much pressure to push, and the trackball seems superfluous except when it glows to signal a new call or message.

Google's real innovation is in how it's selling the Nexus One, a path it will continue to pursue with future products. Most phones in the U.S. are tied to one or another carrier, which subsidizes the cost of the handset in return for your commitment to a service contract. Google is seeking to separate the handset from the service. You can buy it with a service plan for $179, or pay Google $529 and purchase service separately.

At launch, there isn't much of a choice for service. The only carrier currently offering a plan is T-Mobile USA, which charges $79.99 per month. Most folks are probably better off going this route, for now. In theory, you can also use a SIM card from AT&T, but you'd have to use AT&T's older, slower Edge network, not its 3G network.

The choices will multiply over time. This spring will see a Nexus One that runs on the Verizon Wireless network, which uses a different technology than AT&T and T-Mobile. Also in the spring, Vodafone will offer service in Europe. By compelling carriers to compete with one other, Google will weaken their control, meaning more power will eventually flow into consumers' hands—and of course Google's.

While all this is interesting, it's hardly earth-shattering. When Apple introduced the iPhone in 2007, it changed the entire way people thought about wireless devices, ushering in the era of the mobile Web. The Nexus One? It's just a very nice phone. |BW|

BUSINESSWEEK.COM

For past columns and additional tech coverage, go to businessweek.com/technology/
E-mail the author at rjaroslovsky@bloomberg.net

ILLUSTRATION BY PETER ARKLE

www.storemags.com & www.fantamag.com

FEEDBACK

THE JOB MARKET

DON'T CALL ME A VICTIM

I agreed to be interviewed for "The Disposable Worker" (In Depth, Jan. 18) because *BusinessWeek* is a distinguished publication and, having built a home-based business I am proud of, I felt it would be a great opportunity to share my story. To my dismay, the writers chose to present me as "Tammy, a victim of society," which I am certainly not! Contracting and working from home may not be for everyone, but it is empowering and I like it. I am not a victim, nor is my home life put on hold for my job.

I am a proud business owner who pays her taxes and has ample time to be with her kids. I live in a great neighborhood. I chose to start working from home in 2006, and I have built a business with the work I do contracting for LiveOps and operating a virtual-assistant business. I also have a blog designed for individuals to learn more about working from home, especially parents so they can be accessible to their children.

As the writers indicated, businesses want flexibility, but so does the worker. I hear people say all the time "life is too short." I do not regret being away from my family and commuting two hours a day to a job. As a contractor, work doesn't define me; I am defining it.

Tammy DePew-Smith
ORMOND BEACH, FLA.

Your article is the best possible argument in favor of health insurance reform. In today's America, any contingent worker is but one symptom, illness, or injury away from becoming uninsurable.



Illness or injury means no income, the first step on the road to homelessness, foreclosure, and/or bankruptcy. And this situation seems perfectly O.K. to about 40% of our Congress and a significant percentage of the general public, who can't imagine themselves ever being in such a situation. Time for them to wake up and look around to see what we have created in the U.S.

Tony Wasserman
SAN FRANCISCO

INVESTING

NOT EXACTLY SOLID GOLD ADVICE

"Gold's Sister Act" (Personal Business, Jan. 18) claims that some of the "canniest Wall Street advisers live far from Wall Street." Based on the advice in this column, I hope they stay there. The asset allocation suggested here crystallizes what is wrong with our economy. It includes 20% to U.S. and global stocks. The other 80% goes to currencies, energy and resource stocks, and precious metals. We need to be investing in the New Economy, which will create the economic utility and sustainable commerce of a prosperous age. The allocation suggested here, if adopted by a majority of investors, would ensure that we achieve no such thing. These are bets on inflation, a weak dollar, and the success of foreign economies at the expense of our own.

The coming revolution in health care and biotech, the development of green technologies and alternative fuels, and the evolution of the Digital Age will create many millions of new jobs and trillions of dollars of new wealth. Hopefully, using tools such as exchange-traded funds, we will avoid the bubble experience as much as possible. But there is no reward without risk. We need to take risks on behalf of our economy, which certainly makes more sense than betting against it.

Jeffrey L. Feldman
NEW YORK

AIRLINE SECURITY

DOWN, ROVER! WHERE'S THE GATE?

Regarding "Invasion of the Body Scanners" (New Business, Jan. 18): My understanding is that bomb-sniffing dogs could have easily prevented the incident aboard Northwest Flight 253 on Christmas Day but that the public-relations campaign has yet to be invested that would convince airline passengers to submit to the indignity of allowing canines to sniff their crotches, even if such searches potentially would make the difference between life and death.

Stacy Harris
NASHVILLE

CORRECTIONS & CLARIFICATIONS

"The Real Value of Tweets" (New Business, Jan. 18) contained a mathematical miscalculation that led to erroneous conclusions. Twitter's payments from Google and Microsoft work out to $3.13 per thousand tweets, not 3¢ per thousand. This changes the premise of our story. We regret the error.

How to reach *Bloomberg BusinessWeek* | **LETTERS FOR FEEDBACK** We prefer to receive letters via e-mail, without attachments. Writers should disclose any connection or relationship with the subject of their comments. All letters must include an address and daytime and evening phone numbers. We reserve the right to edit letters for clarity and space and to use them in all electronic and print editions. E-mail: bwreader@businessweek.com Fax: (212) 512-6458

BUSINESSWEEK.COM The full texts of *Bloomberg BusinessWeek* and *Bloomberg BusinessWeek* Top News, as well as *BusinessWeek* archives starting in 1991, are available on the Web at businessweek.com and on America Online at keyword **BW**

www.storemags.com & www.fantamag.com

BusinessWeek

PRIVACY NOTICE

Occasionally, and subject to applicable laws, we may share your name, address, and e-mail address with other units within Bloomberg L.P., its subsidiaries, and its affiliates as well as to selected outside companies whose products or services we feel may be ofi nterest to you. Many of our subscribers find these promotions valuable, whether they are shopping for new services or taking advantage of a special offer.

Please be assured that we take your concerns about your privacy seriously, and we intend to take every reasonable effort to protect it. To that end, we have developed a comprehensive Customer Privacy Policy. If you'd like more information about our use of customer data, please review our Privacy Policy, located at: www.businessweek.com/privacy

Please note that this information is stored in a secure location in the U.S. and that access is limited to authorized persons.

If you would prefer not to have your data shared by Bloomberg BusinessWeek with either other units within Bloomberg L.P. or outside companies, please go to: businessweek.rmvs.com/bwo_o.asp

If you have any questions or comments, or want to confirm the accuracy of your information you have provided, please call 1-877-835-6628 or write to:
BusinessWeek Customer Service
1995 G Avenue
Red Oak, IA 51566

Bloomberg BusinessWeek publishes weekly, except when combined issues are published that count as two issues, and when an additional special issue may be published.

Copyright 2009 Bloomberg L.P.

COMPANY INDEX

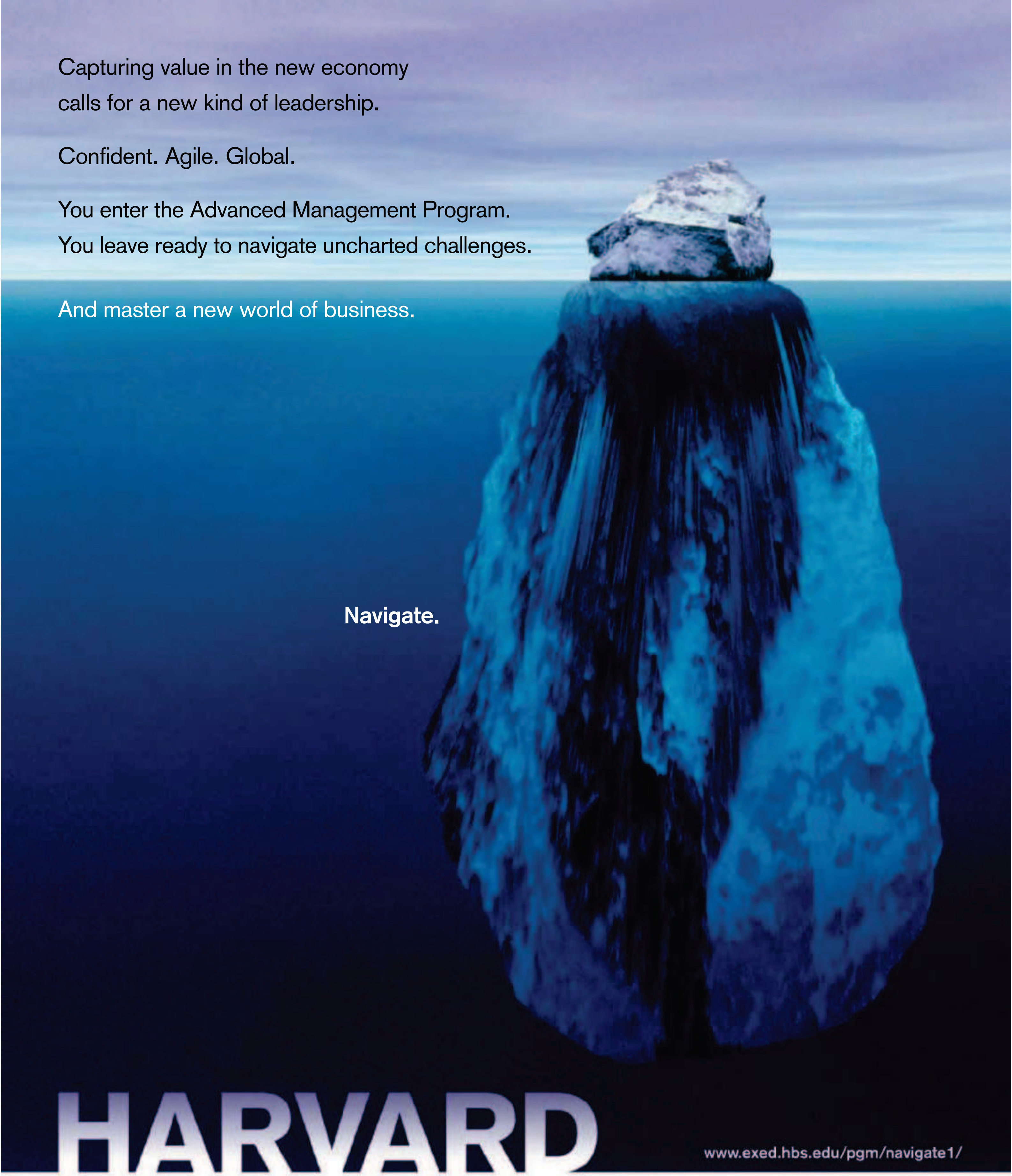
This index gives the starting page for a story or feature with a significant reference to a company. Most subsidiaries are indexed under their own names. Companies listed only in tables are not included.

A Accenture (ACN) 53
AdMob 28, 32
AIG 63, 66
Alan B. Lancz & Assoc. 62
Alcoa (AA) 61
Alibaba 35
Alstom Power 57
Al Tamimi & Co. 26
American Electric Power (AEG) 57
American Express (AXP) 63
Amgen (AMGN) 52
Analysys International 35
Anheuser-Busch InBev 8
AOL 28
Apple (AAPL) 21, 22, 28, 32, 53, 62, 68
Appsavvy 28
Arcelor-Mittal (MT) 23
ARM Holdings 21
Asperion Group 59
Australian Dollar Trust (FXA) 61
Autodesk 55
Azure Capital Partners 32
B Baidu.com 35
Bain Capital 59
Bank of America (BAC) 8, 63
Bank of Nova Scotia 61
Barclays (BCS) 25, 26, 59
Bear Stearns 8
Bernheim Dreyfus 59
BlackRock (BLK) 63
Bloomberg 61
BMW 44, 48
Boeing (BA) 48
Brevan Howard Master Fund 59
Brookside Capital Partners 59
Burger King (BKC) 54
BVI Global 59
C Cadbury Schweppes (CDB) 36
Canadian Dollar Trust (FXC) 61
Cantor Fitzgerald 44
CarLab 44
CBS News 28
Cisco Systems (CSCO) 32, 53
Citadel Investment Group 59
Citigroup (C) 8, 63
Coca-Cola (KO) 50
ConocoPhillips COP) 61
Cowen Group (COWN) 52
CSK Auto 20
CSX (CSX) 61
Curemark 40
CurrencyShares 61
D Davis Advisors 64
Dell (DELL) 22
Deutsche Bank (DB) 21, 26
Didit 28
Dodge & Cox 64
Drake Management 59
E eBay (EBAY) 28, 35
Endpoint Technologies 22
Equilar 20
ETF Securities 61
ETFS Palladium Trust (PALL) 61
ETFS Platinum Trust (PPLT) 61
Eurasia Group 24
F Facebook 8, 55
Fairholme Fund 64
FEMSA (FMX) 8
Fidelity 64
Fifth Third Bancorp (FITB) 63
Ford (F) 28, 44, 48
Forest Labs (FRX) 40
Fox (NWS) 8
Fred Alger Management 62
Freescale Semiconductor (FJL) 21
G Gartner (IT) 28, 55
General Motors 44
Global Source Partners 24
Goldman Sachs (GS) 8, 18, 20, 32, 63
Google (GOOG) 8, 28, 32, 35, 53, 62, 68, 69
Grey Advertising 36
Groupe Auchan 23
Grupo Modelo 8
Gulfstream (GD) 36
H Hewlett-Packard (HPQ) 21, 22, 32, 53
Honda (HMC) 44, 48
HTC 28
I IBM (IBM) 28, 53
IDC 22, 28
ING Growth & Income Fund 62
In-Stat 21
Intel (INTC) 21
International Strategy & Investment 32
J Janus 64
J.D. Power & Assoc. (MHP) 44
JPMorgan Chase (JPM) 8, 35
K Kaufman Bros. 28
Kia 44
Kornitzer Capital Management 36
Kraft Foods (KFT) 36
L LG Electronics 28
LiveOps 69
M Maktoob.com 55
Marvell Technology (MRVL) 21
McDonald's (MCD) 8, 54
Mercedes 44
Microsoft (MSFT) 22, 28, 35, 53, 55, 69
MOG 28
Moody's (MCO) 26
Morgan Stanley (MS) 8, 20, 28
Morningstar (MORN) 64
Motorola (MOT) 20, 28, 68
N National Australia Bank 61
NBC 8
Nestlé (NSRGY) 36
Netflix (NFLX) 28
Nissan (NSANY) 44
Nokia (NOK) 21, 28, 32
Northwest (DAL) 69
Novartis (NVS) 52
Novell (NOVL) 28
NRG Energy (NRG) 57
O Ocean Tomo 53
Ogilvy & Mather Worldwide 36
Oracle (ORCL) 53
Ovum 28
P Panera Bread (PNRA) 54
PepsiCo (PEP) 36, 50
Pfizer (PFE) 20, 40, 53
Philip Morris (PM) 36
Piper Jaffray (PJC) 28, 55
PNC Financial (PNC) 63
Portales Partners 63
Procter & Gamble (PG) 28
Prophet 54
Q Qualcomm (QCOM) 21, 53
Quattro Wireless 28, 32
Quiznos 54
R Research in Motion (RIMM) 28, 68, 72
Rochdale Securities 63
Royce & Associates 64
S Safeway (SWY) 20
Samsung 28
Sanford Bernstein (AB) 22
Seaside Therapeutics 40
Southeastern Asset Management 64
Standard Charter Bank 26
Subaru 44
Subway 54
Sun Microsystems (JAVA) 28
Suzuki 44
T Technomic 54
Tencent 35
Thomson Reuters (TRI) 61
T-Mobile USA 68
totaltravel.com 55
Toyota (TM) 44, 48
T. Rowe Price 64
2953 Analytics 44
Twitter 55
U UBS (UBS) 26
UniCredit 23
USAA Investment Management 63
USAA Value Fund (UVALX) 63
V Van Ness Feldman 57
Verizon Wireless 68
Vodafone 68
Volkswagen 44
Voras Capital Management 24
W Walt Disney (DIS) 16
Wasatch Advisors 62
Wells Fargo (WFC) 63
Wolf Group Asia 35
Y Yacktman Asset Management 36
Yahoo! (YHOO) 28, 35, 55
Yelp 55

BusinessWeek (USPS 080 900)
JANUARY 25, 2010 (ISSN 0007-7135) S T Q ISSUE NO. 4164
Published weekly, except for one issue in January, February, March, July and August by Bloomberg, L.P.
Periodicals postage paid at New York, N.Y., and at additional mailing offices
Executive, Editorial, Circulation, and Advertising Offices: BusinessWeek, 1221 Avenue of the Americas, New York, N.Y. 10020.
Postmaster: Send address changes to BusinessWeek, P.O. Box 8418, Red Oak, IA 51591-1418. Canada Post Publication Mail Agreement Number 40012501. Return undeliverable Canadian addresses to DHL Global Mail, 355 Admiral Blvd-Unit4, Mississauga, ON L5T 2N1. Email: bwkcustserv@cdsfulfillment.com
Registered for GST as Bloomberg L.P. GST #12829 9898 RT0001

Copyright 2009 Bloomberg L.P. All rights reserved.
Title registered in the U.S. Patent Office.
Single Copy Sales: Call 800-298-9867 or email: busweek@nrmsinc.com
Subscriber Services: Call 800-635-1200 or log onto our website: http://www.businessweek.com/custserv/manage.htm
Photocopy Permission: Where necessary, permission is granted by copyright owner for those registered with the Copyright Clearance Center (CCC), 222 Rosewood Drive, Danvers, MA 01923 or email the CCC at info@copyright.com
Custom Reprints: For customized bulk reprints of BusinessWeek articles, contact The YGS Group at 800-360-5549 or email: businessweekreprints@theYGSgroup.com
PRINTED IN THE U.S.A.

www.storemags.com & www.fantamag.com



Every year, senior executives from around the world meet at our Advanced Management Program to explore today's pressing business issues and then apply that learning back at their organizations. Are you ready to join this dynamic global network? Email **amp_info@hbs.edu** to receive more detailed information. Global Perspectives. Tangible Business Results.

HARVARD BUSINESS SCHOOL

EXECUTIVE EDUCATION

www.storemags.com & www.fantamag.com

OUTSIDE SHOT

By ROGER L. MARTIN & JENNIFER RIEL

Innovation's Accidental Enemies

Leaders who demand proof that a new idea will work inadvertently stifle innovation. There's a better way to react to brainstorms

Once upon a time there was a very big bank. Its CEO wanted to better serve its best customers and hired some consultants to tell him what to do.

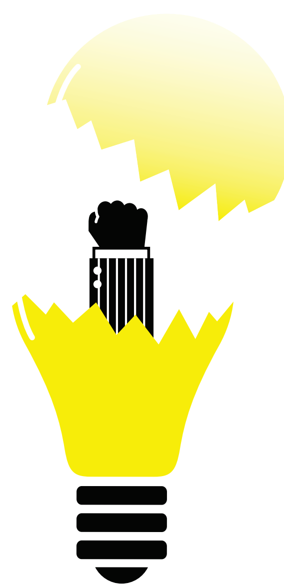
At the time, the very big bank served its high-net-worth customers at stately private banking offices in downtown branches. The consultants discovered that many of these wealthy customers—lawyers, executives, and partners in big professional services firms—were unattractive customers. They chose plain-vanilla services and were both demanding and price-sensitive.

But the consultants found another high-net-worth segment that was underserved: entrepreneurs and partners from smaller firms. These folks had diverse needs, such as mortgages for their homes and investment properties, and investor agreements for multi-partner ventures. But they didn't want to bounce from one banking specialist to another to get a deal done, or drive to a fancy branch filled with high-backed chairs and wood-paneled walls, paid for with their fees. Instead, they wanted integrated, personalized service in their neighborhoods, with no divide between their commercial and personal banking services.

At the final meeting, the consultants presented a strategy built around this new segment. As they wrapped up, the CEO asked: "Have any other big banks done this?" The lead consultant answered brightly, "No, you'd be the first," certain that this would seal the deal.

Not even close. The CEO killed the idea on the spot. And the very big bank's rivals lived happily ever after.

For many companies, innovation is the stuff of fairy tales: fanciful ideas and lurking dangers—all of it unconnected to reality. So it's no surprise that we find it such a struggle. Innovation is killed with the two deadliest words in business: Prove it.



OLIVER MUNDAY

When faced with a new idea, the boardroom impulse is to ask for proof in one of two flavors: deductive and inductive. With deduction, we apply a widely held rule. With induction, we develop a new rule from a wide range of data. In both cases, we use existing information to understand the issue in play. But for breakthroughs, there is no rule or pool of past data to provide certainty. So when a CEO, like our banker friend, demands evidence that an idea will succeed, he is driving innovation away.

Does that mean we are doomed to live in world devoid of proof—that innovation must be consigned to a realm of cross-our-fingers hopefulness? No, it's not so bleak. Instead, when facing an anomalous situation, we can turn to a third form of logic: abductive logic, the logic of what could be. To use abduction, we need to creatively assemble the disparate experiences and bits of data that seem relevant in order to make an inference—a logical leap—to the best possible conclusion.

At Research in Motion, makers of the ubiquitous BlackBerry, abductive logic is embedded in the culture. Mike Lazaridis, RIM's founder and co-CEO, encourages his people to explore big ideas and apparent paradoxes to push beyond what they can prove to be true in order to see what might be true.

In the mid-1990s, RIM was a modestly successful pager company. But Lazaridis saw potential in the idea of a portable e-mail device. He began to consider what it might look like, what it could do. He imagined something much smaller than a laptop but easier to type on than a phone. Laptops were already shrinking and bumping up against limitations on how small a QWERTY keyboard could reasonably get. Lazaridis stepped back to consider how a much tinier keyboard could be feasible—and he achieved a leap of logic: What if we typed using only our thumbs? He soon had a prototype and concrete feedback from it.

Asking what could be true—and jumping into the unknown—is critical to innovation. Nurturing the ideas that result, rather than killing them, can be the tricky part. But once a company clears this hurdle, it can leverage its efforts to produce the proof that leaders depend on to make commitments—and turn the future into fact. |BW|

Roger L. Martin is Dean of the Rotman School of Management at the University of Toronto. Jennifer Riel is Associate Director of the Desautels Centre for Integrative Thinking at Rotman.

www.storemags.com & www.fantamag.com



www.storemags.com & www.fantamag.com